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# "Passing-on" the Right to Restitution

William J. Woodward Jr.

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# "Passing-on" the Right to Restitution

WILLIAM J. WOODWARD, JR.\*

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*This article deals with restitution of illegal taxes which the claimant "passed-on" to or collected from customers in one form or another. Even though the amount of the defendant's "unjust enrichment" has not changed with the plaintiff's passing-on the illegal tax, most of the cases hold passing-on of the tax reduces or eliminates the plaintiff's right to recover restitution. This seems an odd result in the restitution system whose primary stated objective is divesting a defendant's unjust enrichment, and it reveals a complexity in the law of restitution that remains hidden in most other situations. This article describes and analyzes the passing-on cases and explores the broader implications of these cases for the law of restitution.*

## I. INTRODUCTION

It sounds easy enough to say "[a] person who has been unjustly enriched at the expense of another is required to make restitution to that other,"<sup>1</sup> but hidden beneath this tersely stated "principle" of restitution<sup>2</sup> is a tangle of complexity as impressive as the principle's simple statement. Partly, because of this deceptive complexity,<sup>3</sup> the theoretical underpinnings of the law of restitution are undergoing a quiet revolution: major treatises have emerged in the field within the past ten years,<sup>4</sup> important law re-

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\* Associate Professor of Law, Temple University School of Law. Special thanks to Professors Amelia H. Boss, Frank M. McClellan, and William F. Young for their comments on previous drafts of this article, to my colleagues at Indiana University School of Law - Indianapolis and at Temple University School of Law for contributing their ideas, and to John Hegeman for his research assistance.

1. RESTATEMENT OF RESTITUTION § 1 (1937).

2. See *id.* Topic 1, Introductory Note (1937).

3. See J. DAWSON, UNJUST ENRICHMENT 4 (1951); D. DOBBS, HANDBOOK ON THE LAW OF REMEDIES § 4.1, at 226-27 (1973).

4. R. GOFF & G. JONES, THE LAW OF RESTITUTION (2d Ed. 1978); G. PALMER, THE LAW OF RESTITUTION (1978).

view articles have appeared that challenge some of the fundamental working rules of this area of the law;<sup>5</sup> and the drafting of the Restatement (Second) of Restitution is underway.<sup>6</sup>

The idea of restitution proceeds originally from a primitive notion of physical transfer: "restitution" means "restoration,"<sup>7</sup> and, at this primitive level, what gives rise to a restitution claim is a physical transfer of something from plaintiff to defendant that simultaneously makes the plaintiff poorer and the defendant unjustifiably richer by the same amount. If defendant unlawfully takes plaintiff's property,<sup>8</sup> restitution might reverse that taking by ordering the defendant to return to the plaintiff what was taken.<sup>9</sup> The intuitive appeal of restitution is that, by reversing the unlawful taking, a court can divest an unjust gain and replace the plaintiff's loss; thereby, a court can prevent the defendant from gaining from his action while simultaneously compensating the plaintiff for his loss.<sup>10</sup>

The law of restitution, however, has grown far beyond the simple two-party situation to which this model is best suited. In numerous situations, for example, plaintiffs have obtained restitution of benefits that third parties, not the plaintiff, physically trans-

5. See Dawson, *Restitution Without Enrichment*, 61 B.U.L. REV. 563 (1981); Friedmann, *Restitution of Benefits Obtained Through the Appropriation of Property or the Commission of a Wrong*, 80 COLUM. L. REV. 504 (1980); McCamus, *Restitutionary Recovery of Moneys Paid to a Public Authority Under a Mistake of Law: Ignorantia Juris in the Supreme Court of Canada*, 17 U.B.C. L. REV. 233 (1983); Oesterle, *Deficiencies of the Restitutionary Right to Trace Misappropriated Property in Equity and in UCC § 9-306*, 68 CORNELL L. REV. 173 (1983).

6. RESTATEMENT (SECOND) OF RESTITUTION (Tent. Draft No. 2, 1984).

7. D. DOBBS, *supra* note 3, at 222; see RESTATEMENT OF CONTRACTS § 348 comment a (1932): "Restitution means that the defendant must give something back to the plaintiff. This he can not do unless he has received something. The term 'received,' however, is not narrowly defined." *Id.* RESTATEMENT (SECOND) OF CONTRACTS § 344(c) describes the "restitution interest" as "his interest in having restored to him any benefit that he has conferred on the other party." *Id.* See RESTATEMENT (SECOND) OF RESTITUTION, Introductory Note at 7-8 (Tent. Draft No. 1, 1983).

8. See, e.g., *Felder v. Reeth*, 34 F.2d 744 (9th Cir. 1929).

9. The common law analysis to effect this reversal of the original transfer was very early on worked into a contract model: by enlisting the doctrinal proposition that the tortious taking was an "authorized" use of the property by the taker, the law was said to "imply" the defendant's promise to return to the plaintiff the property taken or its value. See, e.g., *id.*; *Dentist's Supply Co. v. Cornelius*, 281 A.D. 306, 307, 119 N.Y.S.2d 570, 571, *aff'd*, 306 N.Y. 624, 116 N.E.2d 238 (1953). Inserting the restitutionary action into the indebitatus assumpsit writ may have influenced the development of the implied contract model.

10. J. DAWSON, *supra* note 3, at 6; Fuller & Purdue, *The Reliance Interest in Contract Damages: I*, 46 YALE L.J. 52, 56 (1936); RESTATEMENT (SECOND) OF RESTITUTION, Introductory Note at 7-8 (Tent. Draft No. 1, 1983).

ferred to the defendant.<sup>11</sup> Although such cases obviously stretch the simple two-party model, they are within the broad field of restitution. Yet, despite the expansion of the unjust enrichment principle beyond the simple two-party situation, the idea of physical transfer, implicit in the restitution idea and suggested in the Restatement's "general principle" and the paradigm case, has remained embedded within the law governing liability for restitution.<sup>12</sup>

Restitution's general formula for relief also is tied closely to the physical transfer model and generates many of the problems with which those in the field have been grappling. In the simple situation where the defendant's activity resulted in his gain and plaintiff's loss, relief amounts to an order that the defendant return the equivalent of "what was taken."<sup>13</sup> Such relief flows logically from both the idea of restitution as "restoration" and from the unjust enrichment principle: if the unifying principle of this area is "one should not be unjustly enriched at the expense of another," what relief could better effectuate that principle than requiring the defendant to return to the plaintiff "what was taken"? Removing unjustified gain *and* compensating the plaintiff both figure into the intuitive appeal of restitution in the simple case. As long as the remedy is simply return of "what was taken" or its equivalent,<sup>14</sup> the remedy satisfies both policies simultaneously and automatically, and it is unnecessary to inquire further into underlying policy support for the relief awarded.

Courts, however, have awarded restitutionary relief in numerous cases in which defendant's gain and plaintiff's loss do not match. We find this in cases in which it is difficult to discern any

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11. Such cases include subrogation cases. *See, e.g.,* Home Owners' Loan Corp. v. Sears, Roebuck & Co., 123 Conn. 232, 193 A. 769 (1937). For other cases in which the defendant's benefit came from third parties, see *Catts v. Phelan*, 43 U.S. 376 (1844); *Federal Sugar Ref. Co. v. U.S. Sugar Equalization Bd., Inc.*, 268 F. 575 (S.D.N.Y. 1920); *Jersey City v. Hague*, 18 N.J. 584, 115 A.2d 8 (1955); *Reading v. Attorney General*, [1951] A.C. 507.

12. *Cf. Friedmann, Restitution of Benefits Obtained Through the Appropriation of Property or the Commission of a Wrong*, 80 COLUM. L. REV. 504 (1980) (suggesting that appropriation of very broadly considered property interests explains many of the cases in which restitutionary liability is imposed).

13. *See* RESTATEMENT OF RESTITUTION § 4 (1937). *See generally* D. DOBBS, *supra* note 3, § 4.1.

14. When a court awards restitution "at law," it must measure and translate "what was taken" into money. This necessity, of course, can be expected to produce complications not present in a restitution in specie case. *See* 2 G. PALMER, *supra* note 4, § 4.2, at 370-77; Dawson, *supra* note 5, 581-82.

policy of compensation.<sup>15</sup> We also find relief granted in cases where there is little basis in defendant's actions for taking the gain away.<sup>16</sup> Although compensation of plaintiffs and deterrence are underlying substantive policies advanced by restitution,<sup>17</sup> the balance worked out in such cases between compensating the plaintiff and keeping unjustified gains from defendants is complex and one which the courts seldom articulate. The general doctrinal formula, depriving the defendant of his "unjust enrichment," suggests little, if any, focus on a policy of compensation, and in many cases, the result is undercompensation or overcompensation of the plaintiff through the award of restitution. On the other hand, one finds a compensation policy quietly operating in many cases not requiring deterrence to exclude recovery where there is "no loss" or to limit the plaintiff's recovery in restitution to what the court perceived as actual loss.<sup>18</sup> Restitutionary doctrine generally fails to articulate these subtleties in terms of substantive policy.

This article is a preliminary and limited exploration of the physical transfer model, the restitution doctrine that model generates, and the interaction of the generated doctrine with the substantive policies that underlie the law of restitution. The focal point of the discussion is the "passing-on" problem found in a group of seldom-acknowledged tax cases illustrated by the facts of *Bacchus Imports, Ltd. v. Dias*,<sup>19</sup> a recent case that reached the Supreme Court of the United States. There plaintiffs were liquor wholesalers who sold liquor to retailers at a base price plus a tax that the state imposed on them. In their suit, plaintiffs contended that the state taxes were unconstitutional and sought restitution of forty-five million dollars in taxes that they had paid to the state. Although the Supreme Court held the tax unconstitutional, it remanded the case to the state court to resolve the central conten-

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15. In breach of fiduciary duty cases, for example, the court will award the profits that defendant derived from "borrowed" trust funds to the plaintiff despite lack of evidence that the plaintiff "lost" them in any real sense. See, e.g., *In re Bond & Mortgage Guarantee Co.*, 303 N.Y. 423, 103 N.E.2d 721 (1952); *Wendt v. Fischer*, 243 N.Y. 439, 154 N.E. 303 (1926) (Cardozo, J); see 1 G. PALMER, *supra* note 4, §§ 2.6, 2.10.

16. These include cases in which the defendant obtained the benefit solely through the plaintiff's mistake, not because of any action on defendant's part. See, e.g., *Home Owners' Loan Corp. v. Rupe*, 225 Iowa 1044, 283 N.W. 108 (1931); *Hill v. Ritchie*, 90 Vt. 318, 98 A. 497 (1916).

17. See, e.g., RESTATEMENT (SECOND) OF RESTITUTION, Introductory Note at 7 (Tent. Draft No. 1, 1983).

18. For a detailed discussion of the myriad permutations that often produce such results, see Dawson, *supra* note 5.

19. 104 S. Ct. 3049 (1984).

tion of the defendants—that the plaintiffs had “passed-on” the tax to (collected the amount of the tax from) their customers and therefore had no right to restitution from the state.

At a superficial level, passing-on an illegal tax looks akin to mitigating one's losses. Bacchus Imports, one might argue, replaced the money paid to the government with money collected from its customers; what was once a loss occasioned by the illegal tax is a loss no longer after passing-on. If the restitutionary remedy functions to compensate for loss, as do damages in the tort system, passing-on the tax is clearly relevant to that remedy. But restitution is a system whose doctrinal engine is the prevention of a defendant's “unjust enrichment.” Thus, restitution's focus is naturally on the defendant and its gain, not on the plaintiff and its loss; the concept of mitigation which has to do with measuring plaintiff's loss—not defendant's gain—would seem to have no place within such a system.

The restitution cases that the author examines here that reach the passing-on question demonstrate that neither the passing-on problem nor the restitution system are as simple as they seem on the surface. The cases are, of course, important in themselves in illustrating several courts' solutions to the same difficult problem within the restitution system. Moreover, because the practice of passing-on costs is so common, these tax cases prompt a consideration of how the restitution system might treat the passing-on problem outside the tax area.<sup>20</sup>

Perhaps more important, the factual circumstances presented in these cases fragment the simpler two-party restitution case and permit easier examination of the dynamics of the restitution system itself. These cases afford the opportunity to consider, in a very narrow context, the relationships among the physical transfer model, articulated restitutionary doctrine, and underlying substantive policy within the law of restitution. They provide an opportunity, within their narrow confines, to consider how the substantive policies of removing unjust gain and compensating for loss interact within the restitution system and the extent to which those substantive policies explicitly underlie the restitutionary doctrine that courts use to decide these cases. Finally, the fact situations of these tax cases may prompt others to consider the extent to which

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20. Indeed, the cases themselves may be of little practical use in the tax area, because, in many situations, statutes govern the recovery of illegal taxes. And even where statutes do not control the disposition, one can often see their influence in the decisions. *See infra* p. 900.

courts might more explicitly use the substantive policy of compensation, which is now largely absent from restitutionary doctrine.

Part II begins by surveying the decisions and looking at general principles they announce. Part III then elaborates on those decisions and develops competing models to explain them. Finally, Part IV considers extension of the developed doctrine to more varied situations and briefly looks at alternative approaches to the passing-on problem in restitution which may be worth considering.

## II. THE DECISIONS AND ANNOUNCED GENERAL PRINCIPLES

The government's unjust enrichment<sup>21</sup> by the collection of an illegal tax supplies a ground for a taxpayer's restitutionary claim against the government.<sup>22</sup> If we limit our focus to the taxpayer and the government, restitution of the illegal taxes both deprives the government of unjustified gain and compensates the taxpayer for loss of the tax money. This situation looks like the classic "restoration" case where the urge to award restitution is greatest. But, as we have become increasingly aware,<sup>23</sup> businesses are prone to treat

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21. Mistake and duress have been the underpinnings for the unjust enrichment claim in tax cases. See generally 3 G. PALMER, *supra* note 4, § 14.20. Where plaintiff seeks a refund on the basis that the legislature imposed the tax under an invalid statute, the plaintiff's "mistake of law" would bar recovery unless the plaintiff paid the tax under "protest," thereby triggering the duress claim. *Id.* at 248-52. Those who pay under an invalid statute and later discover its invalidity are thereby left without relief. *Id.* Where the statute is valid but a taxpayer has simply overpaid, a mistake claim generally results in relief. *Id.* at 252-58. Professor Palmer suggests that the "mistake of law" rule and the duress requirement in this context are doctrinal vehicles designed to protect against a major disruption of governmental finance. *Id.* This would result from a situation where restitution of money was collected under an illegal statute or ordinance. *Id.* at 249. Professor Palmer and others have strongly criticized the mistake of law rule. *Id.* § 14.27, at 337-43; cf. Pannam, *The Recovery of Unconstitutional Taxes in Australia and the United States*, 42 TEX. L. REV. 777 (1964). A current attack is found in McCamus, *Restitutionary Recovery of Moneys Paid to a Public Authority Under a Mistake of Law: Ignorantia Juris In the Supreme Court of Canada*, 17 U.B.C. L. REV. 233 (1983).

Discussion of the substantive requirements for restitution of illegal taxes is largely beyond the scope of this article, the focus of which is the passing-on defense that occasionally forecloses relief to the plaintiff who has been successful in avoiding these other obstacles. The defense, however, is probably related to these doctrines in providing further protection to governmental finance in cases where the court believes that such protection is necessary. See *infra* p. 900.

22. *United States v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386 (1934); *123 East Fifty-Fourth St., Inc. v. United States*, 157 F.2d 68, 70 (2d Cir. 1946) (Hand, J., dissenting); *Rose v. McEachern*, 86 F.2d 231 (5th Cir. 1936), *rev'd on other grounds*, 302 U.S. 56 (1937); *Champ Spring Co. v. United States*, 47 F.2d 1 (8th Cir.), *cert. denied*, 283 U.S. 852 (1931). See generally Field, *The Recovery of Illegal and Unconstitutional Taxes*, 45 HARV. L. REV. 501 (1931).

23. That manufacturers can and do pass-on their liability costs for defective products

new expenses, including taxes directly imposed on them, simply as another cost of doing business and, in one way or another, to include such costs in the prices of what they sell.<sup>24</sup> Thus, in many cases, a business seeking to recover illegal taxes from the state will have included that tax as a cost in the price of what it has sold to others; therefore, customer payments already have replaced some<sup>25</sup> of what it paid to the government. Restitution to the taxpayer of the amount of the tax in such a situation raises the suspicion that the business plaintiff, having gained from customers the amount that was lost to the government, will recover a windfall at the expense of the state or of those upon whom the burden of the tax actually fell. Because the courts perceive a need to avoid such a prospect, this is an area ripe for doctrinal development.

Before proceeding to cases that are the focus of our inquiry, it is necessary to distinguish one form of this general fact pattern. In *Twentieth Century Sporting Club v. United States*,<sup>26</sup> plaintiff ran boxing matches for which the ticket price was to include a federal tax imposed on, and to be paid by, boxing customers based upon a base price exclusive of state taxes. Plaintiff erroneously computed the federal tax on an amount that included state taxes, collected the excessive federal tax from its patrons, remitted the tax to the government, and sued for a refund. Unremarkably, the court denied recovery primarily because the federal statute imposed the tax directly on plaintiff's customers and not on the plaintiff.<sup>27</sup> Because the statute under which it was suing gave rights only to the "taxpayer," plaintiff had no right to recover the erroneously paid taxes.<sup>28</sup>

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to the public has been an early and recurrent justification for strict liability in tort. See, e.g., *Greenman v. Yuba Power Prods. Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962); *Escola v. Coca Cola Bottling Co. of Fresno*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring); *Turner v. International Harvester Co.*, 133 N.J. Super. 277, 288-89, 336 A.2d 62, 69 (1975).

24. See, e.g., Schaefer, *Passing-On Theory in Antitrust Treble Damage Actions: An Economic and Legal Analysis*, 16 WM. & MARY L. REV. 883, 884 (1975).

25. In most cases, the intermediary's sales will have fallen as a result of the higher prices charged, and, therefore, the intermediary will have suffered some loss of profits as a result of the tax even if the entire amount of the tax that it paid to the government has been recouped from its customers. See *infra* p. 887. See generally Bondurant, *The Windfall Tax and Processing Tax Refund Provisions of the Revenue Act of 1936*, 37 MICH. L. REV. 357, 371 (1939); Johnson, *AAA Refunds: A Study in Tax Incidence*, 37 COLUM. L. REV. 910 (1937).

26. 34 F. Supp. 1021 (Ct. Cl. 1940).

27. *Id.* at 1023.

28. For a description of the types of statutes that permeate this area of the law, see Field, *The Recovery of Illegal and Unconstitutional Taxes*, 45 HARV. L. REV. 501 (1932).



The court resolved *Twentieth Century Sporting Club* with statutory analysis, not with restitution principles. A case in which the ultimate customers are the statutory "taxpayers" is, therefore, of limited interest here.<sup>29</sup> The focus here is on cases in which the intermediary is, in fact, the person on whom the statute imposes the tax, but that person has passed along the tax in one form or another to its customers.

The different approaches that the courts took, in three cases briefly described below, illustrate the range of restitutionary doctrine that the judiciary developed within this fact pattern. The author will defer until Part III a close examination of the dynamics of those cases, the doctrine the courts used in deciding them, and the concordance of that doctrine with underlying policy.

*Standard Oil Co. v. Bollinger*<sup>30</sup> is an early case in which a court held that the plaintiff's passing the tax on to its customers barred plaintiff's restitution of unconstitutional taxes. At issue was a tax paid under protest on fuel that the plaintiff used or sold.<sup>31</sup> While protesting, however, plaintiff had been charging and recovering from its customers a base price plus this "tax" it contended was illegal.<sup>32</sup> The opinion outlines a multitude of reasons that emerge in later cases as bases for denying recovery. Because the plaintiff did not intend to deliver the proceeds of the lawsuit to its customers,<sup>33</sup> the defendant argued that the plaintiff was neither

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29. Such cases are of limited interest here, because the availability of a statutory solution to the problem renders resort to principles of restitution unnecessary. It should be noted, however, that the middleman in these cases probably does suffer some form of injury as the result of the imposition of the illegal tax through him onto his customers. It is likely that such a tax on customers will affect the middleman's sales; because of the tax, the customers will have to pay more to purchase the middleman's product. *Cf. infra* p. 887. See generally Johnson, *supra* note 25. Assuming that the lost sales result in lost profits, there is apparently no redress for such loss.

30. 337 Ill. 353, 169 N.E. 236 (1929).

31. The rule appears to be that restitution of invalid taxes may not be had absent "protest" or "duress" of the taxpayer. See 2 G. PALMER, *supra* note 4, § 9.16, at n.8 (citing cases); Field, *The Recovery of Illegal and Unconstitutional Taxes*, 45 HARV. L. REV. 501, 512 (1931); RESTATEMENT OF RESTITUTION § 75 (1937). The duress rule has often erected a high barrier to recovery. In *Flynn v. City & County of San Francisco*, the local government imposed illegal license taxes on various business vehicles and, if the license tags were not displayed, vehicles "were stopped on the city streets, their drivers were escorted to the tax collector's office and were forced to notify their employers they were so held until such time as the money arrived to satisfy the demands made." 18 Cal. 2d 210, 216, 115 P.2d 3, 7 (1941). It took the Supreme Court of California nearly a page to conclude that the illegal tax payments were not voluntarily made! *Id.*

32. Despite the middleman's charging the customers a "tax," it is clear from the opinion that the middleman was the "taxpayer." 337 Ill. at 357, 169 N.E. at 236.

33. *Id.* at 355, 169 N.E. at 236.

the "real party in interest"<sup>34</sup> nor free from "fraud,"<sup>35</sup> that it came to court with unclean hands,<sup>36</sup> and that it suffered no damage and thereby was "estopped" from recovering.<sup>37</sup> Adopting some of these arguments, but moving to a more general plane, the court concluded "[plaintiff] asks the interposition of a court of equity to recover money which does not belong to it, but refuses to be governed by equitable considerations. The record fails to disclose any basis for the relief sought."<sup>38</sup>

*Bollinger* represents the approach of most courts,<sup>39</sup> but the approach is not without its dissenters. At one extreme is the Second Circuit's decision in *123 East Fifty-Fourth Street, Inc. v. United States*.<sup>40</sup> There, following assessment and payment of about a year's worth of federal cabaret taxes, it turned out that plaintiff had not been a statutory "cabaret" and thus had not been subject to the tax. During that year of tax payments, however, plaintiff apparently had been charging its patrons separately for the disputed tax.<sup>41</sup> After holding that the plaintiff's claim was not subject to a statute restricting tax recoveries to those plaintiffs who "bore the burden" of the excessive tax,<sup>42</sup> the majority went on to conclude that "what the plaintiff saw fit to charge became the price of that which was furnished its patrons, when paid that price became

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34. *Id.* at 356, 169 N.E. at 236.

35. *Id.*

36. *Id.* at 356, 169 N.E. at 236-37.

37. *Id.* 356, 169 N.E. at 237.

38. *Id.* at 357, 169 N.E. at 237.

39. See, e.g., *Decorative Carpets, Inc. v. State Bd. of Equalization*, 58 Cal. 2d 252, 373 P.2d 637, 23 Cal. Rptr. 589 (1962) (Traynor, J.); *Benzoline Motor Fuel Co. v. Bollinger*, 353 Ill. 600, 187 N.E. 657 (1933); *Standard Oil Co. v. Bollinger*, 337 Ill. 353, 169 N.E. 236 (1929); *Richardson Lubricating Co. v. Kinney*, 337 Ill. 122, 168 N.E. 886 (1929); *Kesbec, Inc. v. McGoldrick*, 278 N.Y. 293, 16 N.E.2d 288 (1938).

Recently, under a heavy statutory influence, the Supreme Court of Illinois appears to have moved to a different position. In *Consolidated Distilled Prod., Inc. v. Mahin*, liquor distributors and ultimate consumers—but not the retailers who bought from distributors and sold to consumers—sought refund of unconstitutional taxes. 56 Ill. 2d 110, 306 N.E.2d 465 (1974). The consumers lost for want of proof, and the distributors lost, because they had not shown that they had borne the burden of the tax despite the absence of an explicit statutory prerequisite to recovery. *Id.* at 116, 306 N.E. at 468. The court viewed as irrelevant the fact that the distributors had not "specifically charged" the tax. *Id.* at 118-19, 306 N.E.2d at 469. The applicability of this case to situations such as ours (which the statute does not encompass) is questionable, because the court interpreted relevant legislation to reach this situation despite lack of explicit coverage. *Id.* at 118-19, 306 N.E.2d at 469.

40. 157 F.2d 68 (2d Cir. 1946).

41. Both the majority and the dissent made this critical assumption. See *123 East Fifty-Fourth St.*, 157 F.2d at 70 (Hand, J., dissenting); *infra* p. 891-92.

42. 157 F.2d at 69.

plaintiff's money,"<sup>43</sup> and if the customers did not want to pay that "price," they could have left the establishment.<sup>44</sup> In short, plaintiff was entitled to restitution because the money, illegally collected and passed along to the government, belonged in law to the plaintiff when paid over to the government.<sup>45</sup>

Judge Learned Hand saw the case differently. In dissent, after agreeing that the statute did not apply, he stated:

On the other hand, all refunds are based on the theory of unjust enrichment . . . and although the defendant has no positive statutory sanction for its defense, the plaintiff on its part has no standing to claim the refund unless it can show that it is inequitable for the defendant to keep the money.<sup>46</sup>

Judge Hand resolved the equities with an analysis that demonstrates the heavy influence of the physical transfer model. Assuming that the plaintiff separately charged the tax on the customers' bills, the tax money that the customers mistakenly paid to the plaintiff was impressed with a constructive trust in their favor. When the plaintiff paid the tax money to the government, plaintiff, in exchange, received a claim against the government, which, in turn, was impressed with a constructive trust. It thus followed that the plaintiff also would hold any recovery in constructive trust for the plaintiff's customers. Unless the plaintiff could locate the customers and redistribute the recovery (Judge Hand was willing to give plaintiff an opportunity to show that it could),<sup>47</sup> plaintiff could not recover because "the situation as it comes to us is the familiar one, in which the equities are equal and legal title should

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43. *Id.* at 70.

44. *Id.* Cf. *Lash's Prods. v. United States*, 278 U.S. 175 (1929) (Holmes, J.).

45. In general accord, but more heavily based on legislative intent inferred from lack of statutory coverage, is *Builders' Club of Chicago v. United States*, 14 F. Supp. 1020 (Ct. Cl. 1936). See *Van Antwerp v. New York*, 218 N.Y. 422, 113 N.E. 497 (1916); Cf. *Montana v. Sunburst Ref. Co.*, 76 Mont. 472, 248 P. 186 (1926), *cert. denied*, 273 U.S. 722 (1926), (The court opined: "The [state] was not entitled to collect the additional one cent a gallon alleged to have been so collected, and is not entitled to take advantage of [the intermediary's] misrepresentations and share in the gains thus alleged to have been made by it.") *Id.* at 187. Accord *Mason v. New S. Wales*, 102 C.L.R. 108, 146 (1959).

46. 123 *East Fifty-Fourth St.*, 157 F.2d at 70. Judge Hand probably is not using "standing" in this context to mean a restriction arising from concerns about the justiciability of the dispute before the court, which is what the standing restriction has come to mean. See *infra* note 109. Rather, it appears likely that he is using the term to express the sense that the wrong plaintiff is seeking relief. Such usage is common in these passing-on cases. See *supra* p. 895.

47. 123 *East Fifty-Fourth St.*, 157 F.2d at 71.

prevail.”<sup>48</sup> Judge Hand emphasized that if the plaintiff had not charged the tax separately on the bills, he would have found for the plaintiff.<sup>49</sup>

In requiring that the tax be “specifically charged” before the court would sustain the defense, Judge Hand’s dissent is consistent with the analysis of the *Bollinger* court and with the majority of courts addressing this fact situation.<sup>50</sup> The majority in *123 East Fifty-Fourth Street*, on the other hand, found for the plaintiff despite plaintiff’s passing-on the tax and despite the assumed specificity of the tax charges that the plaintiff made to its customers which Judge Hand thought critical. For the majority, being the statutory taxpayer and having title to the money paid was enough to overcome the defense and sustain the plaintiff’s recovery.

The majority in *123 East Fifty-Fourth Street* refused to recognize a passing-on defense in a suit for a tax refund brought by the statutory taxpayer. The other extreme from that resolution is that of the court in *Shannon v. Hughes & Co.*<sup>51</sup> There, the plaintiff challenged and sought to recover an unconstitutional tax on its ice cream operations; plaintiff was met with the defense that it had passed on the tax to its customers and had thereby “shifted to them the economic burden of its imposition.”<sup>52</sup> The court, relying on Lord Mansfield’s statement in *Moses v. MacFerlan*<sup>53</sup> that “defendant may defend himself by everything which shows that the Plaintiff, *ex aequo et bono*, is not entitled to the whole of his demand, or to any part of it,”<sup>54</sup> concluded that, in order to recover restitution, plaintiff must affirmatively demonstrate that the amounts it sought did not include amounts collected from its customers. “[T]o hold otherwise . . . would result in the unjust enrichment of the one seeking to recover the tax from the commonwealth . . . .”<sup>55</sup>

In sustaining the “passing-on” defense where the plaintiff had not “specifically charged” the amount of the tax to its customers, the court in *Shannon v. Hughes & Co.* signaled a willingness to recognize the defense in far more situations than most courts. Nev-

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48. *Id.*

49. *Id.* at 70.

50. *See supra* note 39.

51. 270 Ky. 530, 109 S.W.2d 1174 (1937).

52. *Id.* at 532, 109 S.W.2d at 1175.

53. 2 Burr. 1005, 1010, 97 Eng. Rep. 676, 679 (1760).

54. *Id.*

55. *Shannon*, 207 Ky. at 536, 109 S.W.2d at 1177. *Cf.* *United States v. Jefferson Elec. Mfg. Co.*, 291 U.S. 386, 402-03 (1933).

ertheless, the majority of other courts considering this general fact pattern have more narrowly confined the defense to situations in which that taxpayer has actually billed its own customers the amount of the tax and called it "tax."<sup>56</sup>

One may find an explanation for the varying views in these cases outside the policy or doctrine of restitution in tax legislation. At the time of all three decisions, there existed statutes governing statutory recovery of illegal taxes that required a plaintiff proceeding under such a statute to show that it had "borne the burden" of the tax in order to recover.<sup>57</sup> The resolution that the court reached in *Shannon v. Hughes & Co.* is curiously similar to the result under this type of statute; this result suggests that such statutes may have had some influence on the decision. At the other extreme, because such a federal statute did not control in *123 East Fifty-Fourth Street*, one might explain that decision rejecting the defense where most courts would have sustained it, in part, as the majority's reluctance to extend the principles of such a statute beyond congressionally set boundaries.<sup>58</sup>

But whatever influence the statutes in the area might have, the influence is a silent one, because courts explain their decisions in these cases not in terms of the statutes (which are not directly applicable) but in terms of restitution principles. Does recognition

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56. See *supra* note 39.

57. See generally Johnson, *supra* note 25. The earliest such measure at the federal level was the Revenue Act of 1928, 45 Stat. 886 (1928). Congress required claimants seeking refunds of an Automobile Accessories Tax to affirmatively establish that they had "borne the burden" of the tax. Sustaining the constitutionality of that Act despite its retroactive application, the Supreme Court, in *United States v. Jefferson Elec. Mfg.*, said that "statutes providing for refunds and for suits on claims therefore proceed on the same equitable principles that underlie an action in assumpsit for money had and received." 291 U.S. 386, 402-03 (1934). The Court implied that because the plaintiff was limited to an "equitable" recovery in those actions, the statute did not offend the constitution in its retroactive application. *Id.* at 402-03. For a general discussion of the operation of such measures, see Bondurant, *supra* note 25. For cases applying such a statute in a passing-on situation, see *William Henderson v. Commissioner*, 153 F.2d 442 (5th Cir. 1946); *Interwoven Stocking v. United States*, 144 F.2d 768 (3rd Cir. 1944).

58. The majority preliminarily disposed of the government's contention that the "bore-the-burden" statute did control and that, therefore (according to the government), plaintiff lost for want of proof. 157 F.2d at 69. One could well read that majority opinion as expressing the view that, had Congress wished to extend the reach of the "bore-the-burden" principle to this federal tax, it would have done so, and its failure to so extend the principle expresses congressional intent that the principle not apply to the case before the court. Compare *Builders' Club of Chicago v. United States*, 14 F. Supp. 1020 (Ct. Cl. 1936) (explicitly making such a point) and *Alliance Country Club v. United States*, 62 Ct.Cl. 579 (1926) with *Consolidated Distilled Prod., Inc. v. Mahin*, 57 Ill. 2d 110, 306 N.E.2d 465 (1973) (The court, relying largely on legislative intent, extended a "bore-the-burden" statute to a situation not explicitly within the statute's reach.).

of the passing-on defense have a sound policy basis, or is it simply a covert way to leave tax revenue with the government in illegal tax cases? Is the doctrinal approach courts take to the defense sound? Are there policy justifications for narrowly construing the defense, as do the majority of courts? Is the "specifically charged" restriction a sound way to narrow it?<sup>59</sup> To begin to answer such questions, we turn now in Part III to a closer examination of the situation itself to consider why it might be a somewhat novel problem for the law of restitution to grapple with.

### III. COMPETING MODELS FOR THE CASES: COMPENSATION AND PHYSICAL TRANSFER

Thus far, we have looked at different positions courts have taken, and what they have said in deciding the paradigm case where a plaintiff has passed-on an assessed tax in one way or another to its customers and later has sought to recover the tax that the government illegally assessed. We can begin closer examination of the paradigm situation in this Part by stripping away doctrine and asking the general question: Why should the plaintiff who has passed-on the tax not recover the tax from the government? Alternative intuitive answers one might offer could be that either the plaintiff did not lose anything and will get a windfall if it recovers or the money paid over to the government did not belong to the plaintiff.

Although either answer can yield the same general result, the two answers express very different ways of looking at the problem. The first is an implication of a compensation model—there is no reason to award a recovery to someone who has not lost anything—which is foreign to articulated restitutionary doctrine that focuses on defendant's gain, not the plaintiff's loss in determining whether to impose liability. The second answer rests on a physical transfer model—more in keeping with restitution's history—because the plaintiff was merely a conduit for its "customer's money," plaintiff acquired no "interest" in it, and should not be able to obtain a refund in its own right. Both reasons, in one form or another, appear in these cases; indeed, the cases are excellent vehicles for exploring the differences in the two models which generate these reasons. The compensation rationale, which we will consider first, does not accord with the actual results reached in the cases.

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59. Cf. Bondurant, *supra* note 25, at 360.

*Shannon v. Hughes & Co.*<sup>60</sup> is useful in illustrating the contrast between the compensation analysis and the physical transfer approach. In that case, the plaintiff included the amount of the illegal tax in the price of the ice cream it sold its vendees and later attempted to recover the amount of that tax from the state.<sup>61</sup> The court permitted plaintiff to recover only those amounts that it could affirmatively establish it had not collected from any other source.<sup>62</sup> "To hold otherwise," said the court, "would be manifestly unjust and would result in the unjust enrichment of the one seeking to recover the tax from the commonwealth and supported by no outlay on his part."<sup>63</sup> On the surface, either the lack of a need to compensate Hughes & Co. (and the consequent prospect of a plaintiff's windfall) or the notion that some or all of the tax money paid was not really Hughes & Co.'s can explain the case. The lack of a need for compensation is not, however, a consistent organizing principle. This becomes apparent when one looks at the actual impact of an illegal tax on a plaintiff such as Hughes & Co. in a situation in which the tax might be passed on to its customers.

To see that impact more clearly, consider a couple of variations of the facts of that case. Suppose that Hughes & Co. had absorbed the entire tax so that the tax was not reflected at all in customers' prices and that it did not affect the prices paid to Hughes & Co.'s suppliers. In that situation, the actual, out-of-pocket loss resulting from the imposition of the illegal tax might be the amount of the tax Hughes & Co. paid to the government. Thus, a recovery of the amount of the tax from the state would be roughly compensatory<sup>64</sup> because such a recovery would replace

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60. 270 Ky. 530, 109 S.W.2d 1174 (Ct. App. 1937).

61. *Id.* at 532, 109 S.W.2d at 1175.

62. *Id.* at 536, 109 S.W.2d at 1177.

63. *Id.* The court observed that "[o]rdinarily, one who involuntarily pays a tax imposed by an unconstitutional statute is entitled to a full refund upon mere proof of payment," but the Court added that "the legislature itself may, in the taxing act itself, restrict in certain respects the right of the taxpayer to recover." *Id.* at 532-33, 109 S.W.2d at 1175. The only pertinent statutory restriction in the case at hand was "the aggrieved taxpayer shall pay under protest the tax as and when required and may at any time within two years from the date of such payment sue the Commonwealth . . ." *Id.* at 535, 109 S.W.2d at 1176. Apparently attempting to enlist legislative support for its decision, the court held the statutory term "aggrieved taxpayer" to mean "the person who discharged the tax obligations with his own funds" (i.e., for the most part, customers to whom the tax had been passed-on). The source of the court's interpretation was not legislative history, or other parts of the statute but, rather, the common law of restitution as the court viewed it. Thus, although the court said that a statute actually barred recovery, it seems difficult in this case to lay responsibility for the decision at the feet of the legislature.

64. Were one to measure *all* loss resulting from imposition of a new illegal tax, one

much of the amount actually lost by Hughes & Co. This compensatory recovery would closely match the recovery dictated by the physical transfer model because, under the latter model, the amount of the tax that the plaintiff transferred to the state is the measure of what the state must "return." The "compensation" and "physical transfer" measures diverge markedly, however, once Hughes & Co. begins to pass the tax along to its customers.<sup>65</sup> For example, suppose the opposite extreme, that Hughes & Co. had not totally absorbed the illegal tax but, instead, had increased the price of ice cream to its customers by the exact amount of the tax. The physical transfer model would continue to measure Hughes & Co.'s recovery by what the government had taken, the amount of the tax. It is unlikely, however, that Hughes & Co. in this variation would have suffered a loss measured by the amount of the tax. Nevertheless, it should be apparent that with the increase in price probably came some decrease in ice cream sales and, with that decrease, a probable real loss of profits. The actual facts in *Shannon v. Hughes & Co.* illustrate this quite clearly.

In that case, the court found the tax to be unconstitutional because it was discriminatory and confiscatory.<sup>66</sup> The evidence showed that ice cream sales had plummeted with the imposition of the tax to a point that virtually eliminated profit.<sup>67</sup> Were one to assess the actual loss to plaintiff caused by the imposition of such an illegal tax, which was simply added to the price charged to vendees, that loss would include lost profits due to decreased sales resulting from the increased price required to cover the tax.<sup>68</sup> Passing the tax on to customers in the form of higher prices in many cases does not eliminate the claimant's loss, but simply changes its amount. Because the plaintiff recouped the amount of the tax from

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would want to consider whether the plaintiff incurred expenses other than the tax itself as a result of the illegal tax. One might consider increased personnel costs that are required to process the paperwork made necessary by the new tax, for example, to be loss resulting from the imposition of the tax and thereby recoverable in a compensatory system.

65. The measures similarly diverge if the intermediary can "pass" the tax backward to its own suppliers by forcing them to absorb part or all of the tax by supplying the intermediary at less than the old price. A parallel analysis to that in the text would apply in this situation. Cf. O. VON MEHRING, *THE SHIFTING AND INCIDENCE OF TAXATION* 86-87 (1942); Johnson, *supra* note 25, at 927-28.

66. *Shannon*, 270 Ky. at 530, 109 S.W.2d at 1174 (Ct. App. 1937). The statute was held to be unconstitutional on such grounds in *Martin v. Nocero Ice Cream Co.*, 269 Ky. 151, 106 S.W.2d 64 (1937).

67. *Shannon*, 270 Ky. at 531-32, 109 S.W.2d at 1175.

68. Actual loss resulting from imposition of the tax also might include the expenses incident to collecting the tax. See *supra* note 64.



customers, that amount no longer measures actual loss. But the resulting higher prices may have an impact on sales volume that, as alleged by Hughes & Co., may in turn have an out-of-pocket impact on the vendor's profits.<sup>69</sup>

If the principle that a plaintiff should not be overcompensated were behind the defense, then the court would have inquired into the plaintiff's actual loss resulting from the imposition of the illegal tax, and the court might have permitted a refund up to that amount.<sup>70</sup> We do not find this analysis in the cases, however. Indeed, Hughes & Co. made a similar argument to the court, but the court refused to allow the company to recover because "this would result, in effect, in permitting a recovery of damages against the commonwealth for injuries sustained by the plaintiff through the operation of the taxing act."<sup>71</sup>

A principle that restitution should not overcompensate is also inoperable in situations in which a court would disallow the pass-

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69. Analysis of the economic effects of the illegal tax on the middleman who passes the tax along to customers is much more complex than this. For an excellent discussion of the economic complexity of this problem which laymen can understand, see O. VON MEHRING, *supra* note 65. The loss of sales volume depends in great measure on the "elasticity" of the demand for what the middleman is selling. See generally Johnson, *supra* note 25; Schaefer, *supra* note 24, at 893; cf. Hanover Shoe v. United Shoe Mach., 392 U.S. 481, 489 (1968). Demand is "elastic" when the quantity demanded will decrease sharply with an increase in price. Johnson, *supra* note 25, at 927. Assessing the economic effects, however, is far more complicated than this. For example, a loss of sales volume does not necessarily mean less profit; in some cases, efficiencies of a sleeker operation might mean greater profit margin despite lower sales volume. See, e.g., Bloor v. Falstaff Brewing Corp., 601 F.2d 609 (2d Cir. 1979).

70. Compare subrogation situations where Professor Palmer suggests that an insurance company's subrogation recovery against an insured, which has recovered damages for personal injury from a tortfeasor, should be limited to the amount of *actual* plaintiff overcompensation, that is, the amount that could be shown to exceed *all* loss of the personal injury claimant, including the injured party's pain and suffering award, and litigation expenses and attorney's fees that such a claimant typically pays out of the jury award. 4 G. PALMER, *supra* note 4, at 405-06.

71. *Shannon*, 270 Ky. at 537, 109 S.W.2d at 1177. The court appears to be creating a sharp distinction between restitution and damages in this context, and, at first blush, the distinction seems plausible. Professor McCormick tells us that "[t]he law of damages consists of the rules, standards, and methods used by the courts for measuring in money the compensation given for losses and injuries." C. MCCORMICK, *HANDBOOK OF THE LAW OF DAMAGES* 1 (1935). Nevertheless, is it not in these circumstances more accurate to read Hughes & Co.'s claim as one for restitution whose outer limits are either the amount of the illegal tax or the amount of the plaintiff's damages, whichever is less? If one has sovereign immunity problems with recovery of *damages* against a government, it would appear that those problems would be considerably softened if the "damages" were limited to the amount of the tax the government had no right to collect. As will be developed in Part IV of the text, it might well make policy sense to limit a plaintiff's recovery of restitution in some passing-on situations to the amount of the plaintiff's loss.

ing-on defense. As indicated earlier,<sup>72</sup> most courts restrict the defense to situations in which the plaintiff has "specifically charged" its customers the amount of the tax.<sup>73</sup> In a case such as *Shannon v. Hughes & Co.*, in which the majority of courts would refuse the defense, restitutionary principles would permit recovery in the amount of the tax despite the plaintiff's adding that exact amount to the price at which it sells its goods. Even though the court would measure actual loss differently, the restitutionary recovery would be the amount of the tax, not actual loss.

Finally, the principle against awarding restitution that overcompensates breaks down even when majority-rule courts sustain the defense because the plaintiff has labelled its extra charge to customers a "tax." In such cases, despite occasional suggestions that plaintiff has not "lost" anything,<sup>74</sup> there are seldom sufficient facts from which to draw such a conclusion. When the customer must pay a sales tax at the point of sale, the net "cost" to the customer increases. This increase in cost, in many cases, will deprive the seller of profits it otherwise would have made.<sup>75</sup> But despite the chances that some "loss" will accrue to the seller because of the imposition of the illegal tax, courts refuse *all* recovery and do not inquire into the amount of actual losses the illegal tax might have caused the seller.

Thus, we see very little real operation in these "unjust enrichment" cases of a policy against overcompensating plaintiffs as a reason to deny an otherwise good claim to restitution.<sup>76</sup> In an illegal tax case, if the plaintiff has "passed-on" none of the illegal tax, the defense is unavailable to the government and the measure of recovery—the tax paid—approximately<sup>77</sup> matches the out-of-

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72. See *supra* p. 881.

73. *Decorative Carpets, Inc. v. State Bd. of Equalization*, 58 Cal. 2d 252, 373 P.2d 637, 23 Cal. Rptr. 589 (1962) (Traynor, J.); *Benzoline Motor Fuel Co. v. Bollinger*, 353 Ill. 600, 187 N.E. 657 (1933); *Standard Oil Co. v. Bollinger*, 337 Ill. 353, 169 N.E. 236 (1929); *Richardson Lubricating Co. v. Kinney*, 337 Ill. 122, 168 N.E. 886 (1929); *Kesbec, Inc. v. McGoldrick*, 378 N.Y. 293, 16 N.E.2d 288 (1938).

74. See, e.g., *Standard Oil Co. v. Bollinger*, 337 Ill. 353, 356, 169 N.E. 236, 237 (1929); *Standard Oil Co. v. Bollinger*, 348 Ill. 82, 180 N.E. 396, 398 (1932).

75. See *supra* p. 887.

76. One might surmise that the actual loss to the intermediary would be lower if the intermediary charges the same tax separately rather than adds it into the price. For example, perhaps customers would be less willing to forego a sale if they knew that the greater total price they were required to pay was not due to the seller's greed but due to the government. The literature does not support such distinction—from an economic perspective, net price appears to be the relevant criterion in the decision to buy or not to buy.

77. See *supra* note 64.

pocket loss resulting from the illegal tax.<sup>78</sup> Once, however, the plaintiff has in one way or another passed the tax along to its customers, the amount of the plaintiff's actual loss becomes unrelated to the measure of recovery sought—the amount of the tax paid. Despite the fact that in all cases the government has obtained tax money to which it is not entitled, courts permit or do not permit recovery without sufficient facts to conclude whether recovery of the amount of the tax overcompensates the plaintiff.<sup>79</sup> Yet, these courts suggest that under some circumstances recovery by plaintiff of a "passed-on" tax constitutes unjust enrichment of the plaintiff.<sup>80</sup> The physical transfer model lies at the core of this idea.

As indicated earlier,<sup>81</sup> a second view of the passing-on situation is that the tax money remained, in equity, the customers' and that the plaintiff was merely a conduit for the transmission of that tax money to the government. Under this approach, courts sustain the passing-on defense because the plaintiff-conduit acquired no interest in the tax money and, therefore, has no right to get it back. Viewing it this way, one might readily conclude that to permit the middleman to recover the money from the government would award to the plaintiff its customers' money. Unjust enrichment of the plaintiff would result not from overcompensation but from acquiring property from the government that belongs to someone else.<sup>82</sup>

Judge Learned Hand's dissenting opinion in *123 East Fifty-Fourth Street*<sup>83</sup> may be the best illustration of this analysis. After

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78. This, of course, assumes that the intermediary has not passed the tax back to its suppliers. See *supra* note 65.

79. One might be tempted to conclude from the fact that plaintiff added the tax into the price that it was "cheaper" for the plaintiff to do that rather than maintain the old price and absorb the tax, and, therefore, an award of the amount of the tax as restitution would overcompensate the plaintiff. The plaintiff's addition of a cost into the price, however, shows at best that the plaintiff *believed* it would be more profitable to do that than to absorb the cost entirely. The fact that the plaintiff added its cost into the price, however, does not establish that the plaintiff correctly measured the elasticity of its product's demand; it does not demonstrate that the plaintiff was successful in passing-on the cost to its customers.

80. *Shannon*, 207 Ky. at 536, 109 S.W.2d at 1177; see *123 East Fifty-Fourth St.*, 157 F.2d at 70-71; *Bollinger*, 337 Ill. at 354, 169 N.E. at 236.

81. See *supra* p. 885.

82. As will be developed below, the intermediary seeking the illegal tax money for itself in these cases has "standing," because it has a sufficient stake in the controversy to make the controversy justiciable. See *infra* note 109. The intermediary is the "real party in interest," because it is asserting its own claim and is seeking the money for itself. See *infra* note 110.

83. 157 F.2d 68 (2d Cir. 1946).

assuming that the plaintiff had specifically charged its patrons the cabaret tax that it was erroneously assessed, Judge Hand said the patron's payments to plaintiff were impressed with a constructive trust in the hands of the plaintiff.<sup>84</sup> Judge Hand continued:

When the plaintiff, having taken the money charged with the constructive trust, paid it to the collector, a claim against the collector and the defendant at once arose in its favor, based upon the collector's unlawful extraction. That claim was certainly a substitute for the money whose payment created it; in equity it was the same as though the plaintiff had used the money actually to purchase the claim; and, if a constructive trust attached to the money, the same trust attached to the claim.<sup>85</sup>

Because plaintiff, as Judge Hand analyzed it, was a constructive trustee for the claims of the customers, its inability to show that it could identify the customers whose claims it was equitably asserting was fatal to its claim in equity.<sup>86</sup>

That the customers had "equitable title" to the tax money and that the intermediary was asserting the "equitable claims" of its customers are legal constructs that emerge from a physical transfer approach to the problem. The majority used legal title, a competing legal construct emerging from the same model, to reach the opposite result. In denying the defense, the majority pointed out:

[W]hat the plaintiff saw fit to charge became the price of that which it furnished its patrons and when paid that price became the plaintiff's money. . . . If overcharges were mistakenly made [sic] its patrons they may have had an action against the plaintiff but only a debtor-creditor relationship was created and the actual money the plaintiff received when the checks were paid became its own to use as it pleased.<sup>87</sup>

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84. *Id.* at 70-71.

85. *Id.* at 71.

86. *Id.*

87. *Id.* at 70 (citations omitted).

Illinois Bell Tel. Co. v. Slattery is an interesting case that supports the majority's position. 102 F.2d 58 (7th Cir. 1939). The Supreme Court of the United States previously had found charges that the telephone company had collected to be illegal and ordered the telephone company to refund these overcharges to its customers. *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151 (1934). Because the telephone company was not able to find some of its customers, it was not able to refund all of the overcharges. *Slattery*, 102 F.2d at 62. This suit was over the funds that remained with the telephone company that it could not refund. The state argued that those funds were the property of the missing subscribers and should escheat to the state under the *bona vacanta* doctrine, which provides that property without an owner becomes property of the state. The court rejected the state's claim holding that

The *123 East Fifty-Fourth* opinions underscore two important points. First, although the conceptual idea that permeates this approach to the passing-on problem is that the plaintiff was simply a conduit for "the customers' money," title to that money, in fact, had passed to the plaintiff and then to the government. Thus, the plaintiff is not making a "proprietary claim" in restitution, that is, seeking the return of specific property "owned" by the plaintiff,<sup>88</sup> and principles of tracing which have historically accompanied a proprietary claim in restitution<sup>89</sup> are absent. Rather, the plaintiff simply is seeking judgment at law for the amount of the tax that it paid to the government. Second, whether the intermediary wins or loses depends on whether one chooses "title" of the intermediary or "equitable title" of the customers as the controlling construct. The problem, of course, is that the entire solution to the controversy can turn on that selection which, as the *123 East Fifty-Fourth Street* opinions demonstrate, need not be made on the basis of articulated policy.

It should be apparent that the majority approach, permitting the defense only when the plaintiff has specifically charged a "tax" to customers, is midway in breadth between the narrow defense of the majority in *123 East Fifty-Fourth Street*, which would deny the defense to the government on the basis of legal title (provided that plaintiff was the statutory taxpayer), and the very broad defense of the *Shannon v. Hughes & Co.* court, which would hold for the plaintiff only to the extent the plaintiff could show it had not collected the revenues from other sources. The doctrinal basis for the "specifically charged" restriction that Judge Hand used, and a majority of courts employ in this area, probably lies in the contract between the plaintiff and its customer.

In *Wayne County Produce Co. v. Duffy-Mott*,<sup>90</sup> Duffy-Mott sold its customer cider at a specified price plus a manufacturers' war tax of ten percent. Duffy-Mott paid the amount of the tax to

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the funds were property of the telephone company. Because the absent customers were merely creditors of the phone company and not the owners of the funds, there were no "missing" owners and the *bona vacante* doctrine was inapplicable. *Id.* at 68. *Cf.* *Market St. Ry. Co. v. Railroad Comm'n*, 28 Cal. 2d 363, 171 P.2d 875 (1946) (awarding a fund created by disputed transportation fare increases to the city whose ridership would benefit from the award rather than to other parties having arguably stronger claims of "legal title").

88. Mr. Justice Goff and Professor Jones use "proprietary claim" to mean a claim to specific property in the hands of the defendant which, if successful, would result in a judicial decree requiring that the specific property be turned over to the plaintiff. *See* R. Goff & G. Jones, *supra* note 4, at 42.

89. *Id.* at 47-48.

90. 244 N.Y. 351, 155 N.E. 669 (1927).

the federal government, and a court later held that no tax at all was due on cider.<sup>91</sup> Duffy-Mott obtained a refund from the government, and its customer, in turn, sued to recover the amount it had paid as "tax" in accordance with its contract. In permitting the customer to recover, the court, speaking through Chief Judge Cardozo, analyzed the sales contract as requiring the customer to pay only such amounts of tax as required to discharge Duffy-Mott's liability to the government; accordingly, if Duffy-Mott had no liability to the government, the customer had overpaid and was entitled to restitution of the overpayment which the government had refunded to Duffy-Mott. Even though one might properly characterize the customer's mistake as a "mistake of law,"<sup>92</sup> for which restitution is not ordinarily granted,<sup>93</sup> "[t]he quality of the mistake did not prevent the defendant from recovering the money from the government. It cannot absolve Duffy-Mott from the duty of disposing of the money thus recovered as good conscience shall dictate."<sup>94</sup>

The nature of that contract with the customer would be far different if the vendor simply had included the tax within the price it charged. If the vendor had charged a lump sum, the customer would have no claim that mistake or misrepresentation led to the

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91. *Id.* at 352, 155 N.E. at 669.

92. See 3 G. PALMER, *supra* note 4, § 14.20, at 251.

93. See generally *id.* § 14.27. Commentators have widely criticized this doctrine. See J. DAWSON & G. PALMER, *CASES ON RESTITUTION* 868 (2d ed. 1969); D. DOBBS, *supra* note 3, at 760; 3 G. PALMER *supra* note 4, § 14.27, at 337-43; McCamus, *supra* note 5.

In a case in which the intermediary has collected a tax it owed from customers and thereafter paid that amount to the government, the customers would likely have no claim against the intermediary even if the mistake of law doctrine were not a barrier. Under those circumstances, it is likely that the intermediary would be able to raise its own "passing-on" defense: it divested itself of the unjust enrichment and, therefore, is not liable in restitution to its customers. See D. DOBBS, *supra* note 3, § 11.9, at 767-69; 3 G. PALMER, *supra* note 4, § 16.8, at 523-27. It should be apparent that this is nearly a mirror image of the passing-on defense under discussion—the intermediary *defendant* here is not liable to its customers because it lost its illicit gain, whereas the intermediary *plaintiff* in our cases may not recover because he obtained from its customers a replacement of its "loss."

94. *Duffy-Mott*, 244 N.Y. at 355, 155 N.E. at 670. Cf. *Grand Trunk W. R. Co. v. Chicago & W.I.R. Co.*, 131 F.2d 215 (7th Cir. 1942). There, plaintiff had established it had overpaid and co-lessees had underpaid rentals over time to the defendant lessor. *Id.* at 216. Based on the plaintiff's having established the co-lessee's underpayment, defendant recovered the underpayment from the co-lessees and kept it in a separate fund. *Id.* at 216. This suit was plaintiff's attempt to recover its overpayment from that fund despite the running of the statute of limitations on the original claim for overpayment. The court held that defendant's use of plaintiff's rights to recover the underpayments resulted in a constructive trust in favor of the plaintiff and that plaintiff's cause of action to recover from that fund was not time-barred, because it dated from the creation of the fund and not from the original overpayment. *Id.* at 219.

payment of that "inflated" price, and therefore would have no restitution claim against the vendor as intermediary.<sup>95</sup>

Thus, the difference in the two situations is that when the plaintiff has "specifically charged" the invalid tax to its customer, that customer acquires a colorable restitution claim<sup>96</sup> that it paid the higher price under a mistaken belief that part of the amount paid was "tax."<sup>97</sup> When the tax is simply included in a lump sum charge, on the other hand, the customer has no such claim. Potential rights of the plaintiff's customers against the plaintiff appear to lie at the bottom of the "specifically charged" distinction.

If we consider the measurement of those customer rights as we must in an action at law for restitution, once again the physical transfer model makes its appearance and explains the connection between those customer rights and the rights of the plaintiff. The measure of the customer's restitutionary recovery, if any, would be the amount mistakenly paid to the seller: the amount of the tax.<sup>98</sup> A recovery in that amount is consistent with the physical transfer model—that was the amount the customer "handed over" by mistake—but it is unlikely to be a measure of the defendant's "enrichment" in any other sense. As suggested earlier,<sup>99</sup> the "burden" of an illegal tax passed on to customers is probably, in most cases,<sup>100</sup> shared by the intermediary and its customers. Even if the intermediary-plaintiff has added the entire amount of the illegal tax to the price, it has probably shared some of the total burden of the tax in lost sales and profits.<sup>101</sup> The physical transfer model, however, does

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95. This customer claim is most easily seen as a case of mistake in the performance of a contract. See D. DOBBS, *supra* note 3, § 11.7. One also could see the claim as one of innocent misrepresentation.

96. *Moore v. DesArts*, 1 N.Y. 359 (1848).

97. The "mistake of law" doctrine might bar the customer's claim at least where the intermediary has not already recovered the fund from the government. Cf. *Duffy-Mott*, 244 N.Y. 351, 155 N.E. 669 (1927).

Moreover, where the intermediary paid over to the government the amount of the tax collected from customers, that intermediary probably can claim it passed-on the benefit in good faith, thereby changing position and acquiring a defense against customers who might sue based on their mistake in paying the intermediary. See *supra* note 93.

98. See 3 G. PALMER, *supra* note 4, § 14.8, at 180-81.

99. See *supra* p. 886.

100. Once again, whether and the extent to which the tax is shared depends on a number of economic criteria, among them, the elasticity of the product's demand. See *supra* note 69.

101. If the intermediary had recovered the amount of the tax from the government and were sued by a customer, the customer's recovery of the total amount of the tax paid would probably exceed the intermediary's "net" enrichment, because the intermediary's recovery produced a *net* gain in amount of the tax minus the intermediary's losses occasioned by the imposition of the tax. Professor Dawson has detailed numerous situations in restitution in

not recognize this refinement. In passing-on cases, because the courts perceive that the customer is entitled to restitution of all the tax money he paid to the intermediary, the courts perceive the intermediary to be equitably entitled to none of it.<sup>102</sup> The court treats the case as if the plaintiff-intermediary was, in fact, simply a conduit for the payment of the customer's money to the government.<sup>103</sup>

The physical transfer model is similarly at work when a court in these cases reasons in traditional restitution language<sup>104</sup> that the government's unjust enrichment was "not at the plaintiff's expense."<sup>105</sup> As indicated above, the facts available to the court in these cases do not permit an analysis of who, in fact, bore the burden of the illegal tax. Similarly, as indicated earlier,<sup>106</sup> title to the tax money was in the intermediary, and, therefore, he was not in law a conduit for transmission of the "customers' money." The restriction, as used in these cases, simply expresses the sense that the wrong party is before the court seeking the illegal taxes. Because the courts perceive the specifically charged customers to have restitutionary rights against the intermediary, the enrichment

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which the plaintiff's recovery in restitution exceeds the defendant's "unjust enrichment" measured as net gain. See Dawson, *supra* note 5.

102. Similarly, the amount of tax handed over is unlikely to be the measure of the customer's "loss" if one considers loss to be the amount the customer was unwilling to pay in the first instance. The measurement of loss depends, in part, on the elasticity of the demand for the item that the customer purchased. One must take into account the obvious complexity that such inquiries inject into remedial questions in any reform efforts that proceed in such a direction. See *infra* p. 923-24.

103. The Supreme Court has recently recognized that such is clearly not the case. In *Bacchus Imports, Ltd. v. Dias*, the intermediary sought the recovery of unconstitutional taxes that it had specifically passed-on to its customers. 104 S. Ct. 3049 (1984). The state claimed that the intermediary lacked standing to seek what the state suggested was the customers' money. *Id.* at 3054. In holding that the plaintiff "plainly" had standing, the court pointed out, *inter alia* that it was the intermediary that was liable to the government for the tax and that the tax liability did not depend on whether the customers paid their bills, which included the tax to the intermediary. *Id.* at 3054. If the intermediary has recovered the tax money, it might be liable in restitution to customers, in which case, a judgment at law will result. There is no basis, however, to believe that the intermediary is actually holding "the customer's money."

104. One source of this language is the Restatement (First) provision that "[A] person who has been unjustly enriched at the expense of another is required to make restitution to the other." RESTATEMENT OF RESTITUTION § 1 (1937). The proposed Restatement (Second) of Restitution has expanded this language to encompass more of the varied situations with which this area of the law deals. See RESTATEMENT (SECOND) OF RESTITUTION § 1 (Tent. Draft No. 1 1983).

105. See, e.g., *Svithiod Singing Club v. McKibbin*, 384 Ill. 493, 498, 51 N.E.2d 550, 552 (1943).

106. See *supra* p. 890.



was not "in equity" at the plaintiff's expense. To say that the unjust enrichment was not "at the plaintiff's expense" thus proceeds directly from the use of the physical transfer approach, and the rationale is little more than a makeweight that adds nothing to the resolution of the three party problem before the court.

One may draw the same conclusion with respect to the related alternative rationales that the intermediary should not recover because the intermediary-plaintiff lacked "standing" or was the "real party in interest."<sup>107</sup> Both of these ideas implicitly recognize the possibility of third party rights in the funds held by the government; in both, the proposition is that the court is denying a potentially valid claim, not on the merits, but because the wrong person is making it. Although the perceived existence of third party rights may well animate the decisions in these cases, it would be unwise to import such largely procedural doctrines into the substantive law of restitution.

The critical problem with both rationales is that courts casually use them in these cases—"throw them in," as it were, for good measure. Such use adds nothing to the analysis and can obscure the real basis of the decision on the merits. Most of the courts using these doctrines in this context have asserted, in essence, that *because* the intermediary has no substantive rights, he lacks "standing" or is not the "real party in interest."<sup>108</sup> It should be obvious that such an application of both doctrines turns directly on the substantive merits of the case which are determined by other considerations. Neither doctrine as so used has any independent content; neither aids in reaching a decision on the merits. If properly analyzed, the court probably would hold the intermediary to have "standing" to seek a refund<sup>109</sup> or be the "real party in in-

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107. "Standing" was a defense in *Bacchus Imports, Ltd. v. Dias*, 104 S. Ct. 3049 (1984) and *Standard Oil Co. v. Bollinger*, 337 Ill. 353, 169 N.E. 236 (1929). Defendants also challenged plaintiff's status as a "real party in interest" in *Bollinger*, 337 Ill. 353, 169 N.E. 236 (1929) and vaguely questioned plaintiff's status in *United States v. Jefferson Elec. Co.*, 291 U.S. 386 (1934).

108. *Bacchus Imports, Ltd. v. Dias*, is the only case that the author found in which a court approached either of these procedural restrictions directly in this context. 104 S. Ct. 3049 (1984). As discussed in the next note, the Court held that the intermediary had "standing" to assert its claim. *Id.* at 3054.

109. The question of "standing" involves an inquiry into whether the plaintiff "has a sufficient stake in an otherwise justiciable controversy to obtain judicial resolution of that controversy." L. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 3-17, at 79 (1978) (quoting *Sierra Club v. Morton*, 405 U.S. 727, 731 (1972)). The plaintiff has standing when it alleges that the defendant's action has caused the plaintiff economic or other injury. B. SCHWARTZ, *ADMINISTRATIVE LAW* § 153, at 455 (1976). The taxpayer-intermediary, in these cases, probably

terest" to the claim the intermediary is asserting.<sup>110</sup> As the courts have used these rationales in the cases, however, they are make-weights, dependent directly on other determinations for their application. As the courts have applied these rationales, they tend to obscure the underlying substantive decision that the intermediary does or does not have restitutionary rights to the illegal taxes.

More than the mere existence of third party rights to "the tax money" is generally required under majority-rule formulations of the "specifically charged" restriction. In Judge Hand's dissenting

has suffered some financial injury as a result of the illegal tax even where it has recouped the entire amount of the tax from the customers. *See supra* note 65 and accompanying text.

The Supreme Court of the United States recently decided the standing question in this context in *Bacchus Imports, Ltd. v. Dias*, 104 S. Ct. 3049 (1984). The state argued that the taxes were not unconstitutional, and, in any event, because the plaintiffs had passed on the illegal taxes to their customers, they lacked standing to challenge their illegality. *Id.* at 3054. After holding the challenged taxes unconstitutional, the Supreme Court stated that the wholesalers were liable for the tax whether or not their customers paid their bills, that the tax could have harmed them competitively, and concluded that the "wholesalers are surely entitled to litigate whether the discriminatory tax had an adverse competitive impact on their business." *Id.* That analysis would be equally applicable to an intermediary's claim that, despite its passing on the tax, it has standing to litigate whether the illegal tax had an adverse impact on its profits. *See Shannon v. Hughes & Co.*, 270 Ky. 530, 109 S.W.2d 1174 (1937).

110. Requiring that a "real party in interest" be the plaintiff in an action is a procedural rule related historically to the common law requirement that an action be brought in the name of the person having "title" to the right on which plaintiff sues. 6 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 1541, at 633 (1971). As the Advisory Committee stated in the Note to the 1966 Amendment to Federal Rule of Civil Procedure 17(a), *quoted in id.* § 1543, at 644: "[T]he modern function of the rule in its negative aspect is simply to protect the defendant against a subsequent action by the party actually entitled to recover . . . ." *Id.* It would appear that, in these cases, the intermediary is, in fact, the "real party in interest" when seeking to recover a passed-on tax for its own benefit from the government.

First, the intermediary is simply seeking a money judgment against the government. The right on which plaintiff sues is the alleged right to get such a refund despite having passed-on the tax. If such a right exists, the intermediary "owns" the right. Second, the intermediary, being the "taxpayer," would seem to be a more appropriate party to challenge an illegal tax imposed on it than would be its customers who felt the impact in a less obvious way. As Professor Schwartz has stated:

The law starts with the individual who may be called the *obvious* party. He is the subject or object of the agency act—the individual ordered to do or not to do specified things, the applicant for a license or other grant, the company whose rates or practices are being controlled.

B. SCHWARTZ, *supra* note 109, § 94, at 264. Finally, as indicated below, in the situation we have been examining, the customers generally have no rights against the government, because they are not "taxpayers" with a statutory or common law right to sue. *See infra* p. 905. The author has not found a case in this area in which the court granted customers restitutionary rights against the government on the basis that they bore the burden of an illegal tax assessed against the seller. Accordingly, a double recovery problem, which the real party in interest rule functions to prevent, generally will not arise.

opinion in *123 East Fifty-Fourth Street*,<sup>111</sup> it was the existence of such rights and the inability to identify the holders of those rights that were the basis of the defense. In his words, "the [government] could not keep the money merely because it feared that the plaintiff would be truant to its duty [to refund the recovered amount to its customers]."<sup>112</sup> The court, in *Bollinger*,<sup>113</sup> was more generous toward the government with its analogous requirement. In that case, the court found as a fact that the plaintiff intended to keep the recovery being sought<sup>114</sup> despite its apparent ability to identify the customers to whom it had passed-on the tax. The court denied recovery.<sup>115</sup> In general accord with *Bollinger* is the innovative approach taken in *Decorative Carpets, Inc. v. State Board of Equalization*.<sup>116</sup> There, *Decorative Carpets* had the names and addresses of the 882 customers that had paid too much based on an erroneous computation of taxes, but it stipulated that it was seeking the refund in its own right and did not intend to pass the refund along to the customers.<sup>117</sup> The court, through Justice Traynor, did not entirely bar recovery but held that the state agency "may therefore insist as a condition of refunding overpayments to the plaintiff that it discharge its trust obligations to its customers."<sup>118</sup> The court entered a conditional judgment for the plaintiff. Thus, under Judge Hand's approach, if the customers are identifiable, the de-

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111. 157 F.2d 68 (2d Cir. 1946).

112. *Id.* at 71. Although it is unclear what the result would have been under Judge Hand's analysis if only some of the customers had been identifiable, the court might properly have limited recovery to the amount that plaintiff could have refunded. *Cf. Decorative Carpets, Inc. v. State Bd. of Equalization*, 58 Cal. 2d 252, 252, 373 P.2d 637, 639, 23 Cal. Rptr. 589, 589 (1962) (Justice Traynor remanded the middleman's case to the trial court with instructions to enter judgment for the plaintiff "only if it submitted proof that the refund will be returned to plaintiff's customers from whom the excess payments were erroneously collected.").

113. 337 Ill. 353, 169 N.E. 236 (1929).

114. *Id.* at 356, 169 N.E. at 237.

115. *Id.* at 357, 169 N.E. at 237.

116. 58 Cal. 252, 373 P.2d 637, 23 Cal. Rptr. 589 (1962) (Traynor, C.J.).

117. *Id.* at 254, 373 P.2d at 638, 23 Cal. Rptr. at 590.

118. *Id.* at 255, 373 P.2d at 638, 23 Cal. Rptr. at 590. It is clear from the opinion that the factors that strongly influenced the decision included pending legislation that would have achieved a similar result and the inability of the customers to sue and recover the illegal tax of which the court perceived them to have borne the burden. For a different analysis of this last point, see *Upchurch Packing Co. v. United States*, 151 F.2d 983 (5th Cir. 1945). There, the plaintiff's subsidiary had been the taxpayer and the plaintiff-parent had borne the burden of the illegal tax. The parent subsequently acquired the subsidiary through corporate reorganization. The court, through strict statutory construction, rejected its assertion of a statutory right to stand in the shoes of its former subsidiary and recover the illegal tax. *Id.* at 986.

fense is barred; under *Bollinger* and *Decorative Carpets*, the defense is not foreclosed by the existence of identifiable customers, provided the plaintiff is seeking recovery on its own behalf and not on behalf of its customers. This latter approach suggests that the courts are not content to rely on the customers of the plaintiff bringing their own actions to deprive the plaintiff of the restitutionary recovery that the courts view in these cases as being sought in the customers' behalf.

It may be, however, that Judge Hand's dictum that "the [government] could not keep the money merely because it feared that the plaintiff would be truant to its duty [to refund the recovered amount to its customers]"<sup>119</sup> is more in accord with the received wisdom in the law of restitution. If it is correct that the "specifically charged" restriction finds its basis in the rights of third parties, the passing-on defense, as the courts have implemented it, denies restitution to the plaintiff because of the existence of third-party rights that courts perceive to be stronger than the rights of the plaintiff.<sup>120</sup> Such a defense seems, at first blush, at odds with a principle found in the Restatement which could apply, by analogy,<sup>121</sup> to these passing-on situations. Section 141(1) states:

A person who has taken from the possession of another, or has received from or on account of another, things in which a third person has an interest which is superior and antagonistic to the interest of the other, cannot defeat the claim of the other for restitution merely because of such superior interests.<sup>122</sup>

This Restatement provision is consistent with a view that the prime function of the law of restitution is to divest the defendant's

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119. 157 F.2d at 71.

120. "Stronger" in this context is an understatement—the physical transfer model suggests that the intermediary has no rights to the tax money that is paid over, because the customers have the rights to all of it. See *supra* p. 890-91.

121. Section 141(1), quoted in the text, by its terms, seems to apply only to actions for specific restitution.

122. The rule works most easily in cases in which the defendant has wrongfully deprived the plaintiff of possession of something not belonging to the plaintiff. For policy reasons, one would not permit the defendant to defend its wrongful actions by questioning the plaintiff's possessory rights to what was taken. Once, however, one moves into areas in which defendant has not obtained the property through its own wrongful actions, the defense becomes more difficult to justify on policy grounds. Comment (a) to the section seems to recognize this difficulty but suggests that the rule is the same regardless of the character of the defendant's activity. See Annot., 150 A.L.R. 163 (1944); RESTATEMENT OF RESTITUTION § 141(1). The idea articulated by the Restatement provision has an ancient lineage. Cf. *Armory v. Delamirie*, 1 Strange 505, 93 Eng. Rep. 664 (K.B. 1772) (disallowing defense that a finder of lost property could not maintain an action in trover).

unjust enrichment. When we are certain that the defendant holds property to which it is not entitled and a plaintiff presents a colorable claim to that property in which third parties also have an interest, we are presented with certain "unjust enrichment" of the defendant to weigh against possible or probable "unjust enrichment" of the plaintiff if the third parties do not assert their rights to the property. Of the two parties before the court in such a case, plaintiff likely has the stronger claim. Under such circumstances, a court might well, on principle, find for the plaintiff and, in so doing, exchange a risk of potential unjust enrichment of the plaintiff for certain divesting of the defendant's unjust enrichment.<sup>123</sup> Judge Hand's approach is consistent with this analysis. Only when the third parties, whom the courts perceive to be the "equitable owners" of the property, are unidentifiable, can we be as certain that an award of restitution under a physical transfer model will unjustly enrich the plaintiff to the degree that we are certain of the defendant's unjust enrichment. If one balances these certainties, inertia<sup>124</sup> suggests a victory for the defendant.<sup>125</sup>

Although one might question applying the underlying principle of the quoted Restatement section in an illegal tax case,<sup>126</sup> Judge Hand's position on this issue seems in accord with it. His opinion, however, was a dissent, and the author has not found any cases in this area in which a court has held for the plaintiff in accordance with Judge Hand's views on this particular question.<sup>127</sup> His approach, of course, allows a plaintiff to recover in cases such as *Bollinger*, where plaintiff's customers are identifiable. The majority approach, on the other hand, produces a broadened passing-on defense and therefore fewer plaintiffs' recoveries. The fact that

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123. Efficiency and simplicity also support the Restatement rule. Once we allow third party rights to affect the rights of the plaintiff, the character and strength of those rights become relevant in the case between the parties before the court. The added litigation burden of ascertaining absent third party rights in the suit before the court and the capacity of that burden to indirectly affect the recovery prospects of the plaintiff before the court make a strong case for avoiding such an inquiry in the first instance.

124. Professor Palmer uses "judicial inertia" in connection with his discussion of the defense of discharge for value. 3 G. PALMER, *supra* note 4, § 16.6, at 500.

125. One can express such inertia in terms of burden of proof or as a preference for the party with title when the equities are evenly balanced, as in 123 East Fifty-Fourth Street, Inc. v. United States, 157 F.2d 68, 71 (2d Cir. 1946)(Hand, J., dissenting).

126. See *supra* note 121.

127. The court, in *State v. Sunburst Ref. Co.*, goes further than Judge Hand would. 76 Mont. 472, 248 P. 186 (1926). There, the court refused to allow alleged customers' rights to bar restitution. Although not at issue, it appears from the opinion that the customers were unidentifiable, and, if so, the decision stands for the rejection of the passing-on defense in a tax case. See *Mason v. New S. Wales*, 102 C.L.R. 108, 146 (1959).

the government is always the defendant in these cases probably has something to do with the broadened defense that the majority-rule courts favor.<sup>128</sup>

The government is of course arguably different from other defendants because it disburses its income—even if acquired through illegal taxes—for the “public welfare,” and, at least in that sense, the government itself is simply a conduit channeling funds for the benefit of all.<sup>129</sup> Thus, the balance of equities between plaintiff and defendant in these cases may not seem the same when the defendant is the government. It may not be merely a choice between certain unjust enrichment of the defendant and probable unjust enrichment of the plaintiff; rather, the choices may be between leaving the funds with the government, which will redistribute them (or has already done so) for the “public good,” and leaving them with the plaintiff which will redistribute them only if its customers force it to do so through litigation.

Moreover, because courts perceive the government to be channeling its funds for worthwhile purposes, a large judgment of restitution against the government might be less desirable than the same large judgment against a private party. Thus, courts try to avoid large restitutionary payments to the plaintiff that may temporarily disturb the government’s supply of needed services elsewhere.<sup>130</sup> Coupled, perhaps, with a perception that the plaintiff is seeking a windfall or is not in need of compensation, it is understandable that when the government is the defendant, as it inevita-

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128. One can also read the broadened majority-rule defense as a narrowing of the principle that the defendant may not defend a restitution claim by asserting superior third party rights to what the plaintiff seeks. As suggested earlier, Restatement § 141(1) seems to have less intuitive force as one moves from “wrongful act” cases, where the defendant “wrongfully” brought about his own gain, to mistake cases, where the defendant was simply a passive recipient of the gain. See *supra* note 122. If the principle applies at all in law cases, the majority’s apparent refusal to implement such a principle in these cases may signal that the Restatement principle is not equally applicable across the broad spectrum of restitution cases.

129. But see *Maricopa County v. Avondale*, 12 Ariz. App. 109, 467 P.2d 949 (1970) (discussed in Dawson, *supra* note 5, at 567-68). See *Paramount Film Distrib. Corp. v. New York*, 30 N.Y.2d 415, 285 N.E.2d 695, 334 N.Y.S.2d 388 (1972).

130. See Field, *supra* note 22, at 516; 3 G. PALMER, *supra* note 4, § 14.20. There does not appear to be any strong evidence that the vigor with which courts apply the passing-on defense is related to the potential fiscal disruption that one expects to result from a plaintiff’s victory. 123 *East Fifty-Fourth St.*, however, does offer some evidence of a relationship. 157 F.2d 68 (2d Cir. 1946). In that case, the plaintiff claimed that the government had illegally assessed the tax, and not that the statute was unconstitutional. *Id.* at 68-69. Moreover, its claim was against the United States, which is better able than state or local governments to absorb restitution claims. As indicated in the text, the court rejected the passing-on defense. See *Builders’ Club of Chicago v. United States*, 14 F. Supp. 1020 (Ct. Cl. 1936).

bly is in these cases, the balance may tilt more toward the defendant than in other cases.<sup>131</sup> The tendency, observed elsewhere<sup>132</sup> and evident here, to favor the government in tax cases, may help explain the decisions in a number of the cases in this area including the more erratic ones such as *Standard Oil Co. v. Bollinger (Bollinger II)*,<sup>133</sup> a sequel to the original case. In *Bollinger II*, the oil company alleged that it did not intend to keep the recovery, had agreed to refund it to its customers on a pro rata basis, and had received protests from several customers. Among other grounds,<sup>134</sup> the court denied recovery because the plaintiff did not allege that it had suffered any loss; regardless of what it may have intended to do with the recovered funds, plaintiff had shown "no right to recover it."<sup>135</sup> The "traditional analysis," as articulated in *Bollinger I*,<sup>136</sup> fails to explain the case because plaintiff here appeared to fit within that theory's requirements for recovery, that is, the plaintiff claimed to be seeking recovery of the illegal taxes,

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131. Courts occasionally use a narrowed form of the "government-as-bounty-spreader" idea to reinforce a holding that the plaintiff may not recover. This is the "quid pro quo" argument which maintains that the illegal revenues were returned to the claimant in the form of other benefits, and, therefore, the claimant has no reason to complain. For example, in *Universal Film Exchanges v. Board of Fin. & Revenue*, the plaintiffs sought refund of unconstitutional censorship license fees that they paid for on their motion pictures from 1915 to 1953. 409 Pa. 180, 185 A.2d 542 (1962). Although the court denied recovery under a rule requiring that the plaintiff pay such fees under duress, the court added:

From these [inspection] services real and substantial benefits inured to these appellants and others engaged in the business of distributing motion picture film. There was a benefit without resulting loss to those now complaining in as much as the cost incident to these services was, undoubtedly, cast upon the theatre-going public.

*Id.* at 191, 185 A.2d at 548 (citing *Box Office Pictures v. Board of Revenue & Fin.*, 402 Pa. 511, 166 A.2d 656, 660-61 (1961)). Not only did the plaintiff recoup the loss of tax money, the plaintiff also received the benefit of government regulation. Under such an approach to the facts, it indeed would be difficult to find for the plaintiff. *See Paramount Film Distrib. Corp. v. New York*, 30 N.Y.2d 415, 285 N.E.2d 695, 334 N.Y.S.2d 388 (1972); *Field, supra* note 22, at 514-15.

132. *See, e.g., Field, supra* note 22, at 570. For a case showing such a tendency under a "bore-the-burden" statute, see *Upchurch Packing Co. v. United States*, 151 F.2d 983 (5th Cir. 1945) (discussed *supra* note 118).

133. 348 Ill. 82, 180 N.E. 396 (1932).

134. Despite plaintiff's filing protests to the collection of the tax, the court found that, because the plaintiff "voluntarily" paid the tax to the government, the plaintiff could not recover. *Id.* at 89, 180 N.E. at 398. The rule that "voluntarily" paid illegal taxes are not recoverable under common law restitution is thought to be based on the fear that a more lenient rule might result in the disruption of fiscal affairs, and it is the converse of the rule that, to be recoverable, taxes must be paid under "duress." *See, e.g., 3 G. PALMER, supra* note 4, § 14.20, at 249-50. *See also supra* note 31; *Pannam, supra* note 21, at 790.

135. *Bollinger II*, 348 Ill. at 89, 180 N.E. at 398.

136. *See supra* p. 880.

not in its own right, but on behalf of its customers. And although it appears as clearly in this case as in any that a policy against overcompensation motivated the court, there were insufficient facts available to conclude whether overcompensation, in fact, would result from recovery.<sup>137</sup> The case is thus inconsistent with any of the identified rationales for the defense.

The policy of protecting the treasury may help explain *Bollinger II*. Yet, the case may be an aberration because only a year later, the same court, in *Benzoline Motor Fuel Co. v. Bollinger*,<sup>138</sup> held for the plaintiff on very similar facts. *Bollinger II*, however, is instructive because it suggests the weakness of having the defense turn on whether the plaintiff is seeking recovery in its own right or on behalf of its customers. When one asserts that the intermediary is seeking a recovery on behalf of the customers, the image is of the intermediary simply passing-on the recovery and deriving no benefit from it. The scenario in real life is likely to be far different.

We know in *Bollinger II* that the plaintiff had agreed to refund its recovery to its customers. We do not know what the plaintiff received in exchange for its promise, and, in such a case, the value of the consideration exchanged for that promise could be quite large. Indeed, if the customers were barred from recovery against the government in their own right, it would be rational for them to pay something—money, firm future business, higher future payments, good will—approaching the amount of the illegal tax in exchange for their right to get the proceeds of the recovery.<sup>139</sup>

When the passing-through defense turns on whether the plaintiff is seeking the tax money on its own behalf, there is, however,

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137. See *supra* p. 887.

138. 353 Ill. at 600, 187 N.E. 657 (1933).

139. The customers, if rational, will choose that which makes them better off. Because, by hypothesis, they get nothing without the intermediary's help and get the amount of the tax with its help, one can generally determine how much they would be willing to pay to get the intermediary's help. If one could quantify the aggravation and expense of participating—even on the sidelines—in litigation, and, more generally, of dealing with the intermediary concerning this problem, one could determine the break-even point and, therefore, the minimum net recovery they would require for "participating." The maximum "price" they would be willing to pay the intermediary would be that amount that, when subtracted from the amount of the illegal taxes, would give them the break-even amount. Similarly, the intermediary, by hypothesis, gets nothing without the aid of the customers, because without them it is seeking the refund on its own behalf and is thereby barred from recovery. It will proceed forward if it will be better off in so doing and will accept as a price nothing less than an amount that will net it—after costs of litigation, aggravation, dealing with the customers—some amount greater than zero. The deal struck between the intermediary and the customers will be priced within those limits.



no distinction that one may draw in principle between the plaintiff that has received little or nothing in exchange for "returning" the money to its customers and the plaintiff that has obtained from the customers a very high price in exchange for a right to receive what is viewed as the customers' own property. Intuitively, one may believe that the plaintiff's "equity," vis-à-vis the government, is vastly different in these two extreme cases; but that belief probably stems from a sense that an intermediary in search of a windfall can avoid the impact of the passing-on defense simply by charging a high enough price to its customers for seeking a recovery on their behalf. Getting at this problem, however, is difficult. Because one must determine when the intermediary has so contracted with customers as to achieve an "impermissible" windfall, a principled distinction between cases of this kind is nearly impossible. For example, would the intermediary be entitled to any "profit" on the deal with the customers? If so, what is an impermissible profit, and what is not? And how does one even calculate "profit"? Are losses resulting from the tax to be counted as "costs"? What of the intermediary's aggravation and disruption of its business which results from litigation on behalf of the customers? Similarly, does the customer good will resulting from the intermediary's services count in calculating the "price"?

Of course, the prospect of an intermediary's windfall plays no *doctrinal* part in the physical transfer model and, therefore, such matters should be of no concern to a court employing that doctrinal approach. But once one gains awareness that the intermediary is not likely to be litigating its customers' rights for nothing, the image of its passing-on the entire recovery to customers and deriving no benefit from it becomes a strained one. It may be that the *Bollinger II* court was worried about the possibility that the plaintiff's agreement to return the money came at some cost to the customers. On the other hand, the *Benzoline Motor Fuel* court may have recognized the irrelevance and the futility of attempting an inquiry into the nature of the exchange.

Judge Hand's approach, which turns on inability to identify customers, produces a narrower defense, but perhaps wisely, avoids such problems entirely. In his approach, the intermediary, in fact, is seeking the refund on its own behalf but will be subject to customer suits once it recovers the taxes. There is no notion that the intermediary will simply pass-on the recovery deriving no benefit from having recovered it.

The desire to protect the treasury also gives some insight into

the analysis considered earlier <sup>140</sup> in *Shannon v. Hughes & Co.*<sup>141</sup> Under that formulation, in which it is unnecessary that the plaintiff have "specifically charged" the tax, perceived rights of the customers have little or nothing to do with the decision. In that situation, in which the tax is "passed-on" as part of a lump sum price, the total price that the customer paid for the goods is, as a matter of the contract between buyer and seller, what the buyer exchanged for the goods. There is no right based on mistake of fact or of law entitling the customer to a refund from the plaintiff if the tax proves invalid, because the customer actually had made no mistake of either type;<sup>142</sup> for similar reasons, and because of statutory restrictions, the customers in such cases are unlikely to have actions directly against the government.

Thus, under the *Shannon v. Hughes & Co.* analysis, in a case in which the seller has treated the tax as a cost and raised the selling price by that amount, the ultimate result is that the illegal and perhaps unconstitutional<sup>143</sup> tax remains with the government. The plaintiff cannot recover the tax from the government because of the defense. Also, it is unlikely that the customers have any rights against the government because of statutory restrictions,<sup>144</sup> and because customers willingly and without mistake paid the higher price. Similarly, because they made no mistake, the customers are probably left with no grounds for recovering the amount of the tax from the plaintiff.<sup>145</sup>

Thus far, we have examined several versions of the passing-on defense in these tax cases. When the government effectively de-

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140. See *supra* p. 883.

141. 207 Ky. 530, 109 S.W.2d 1174 (Ct. App. 1937).

142. See, e.g., *Texas Co. v. Harold*, 153 So. 442 (1933); cf. *Johnson v. Ingleheart Bros.*, 95 F.2d 4 (7th Cir. 1938) (denying refunds to customers from the middleman despite contract provisions arguably to the contrary); *Noll Baking & Ice Cream Co. v. Sparks Milling Co.*, 304 Ill. App. 624, 26 N.E.2d 425 (1940) (same).

143. Although one might expect otherwise, there does not seem to be any distinction in doctrinal approach between a plaintiff attempting to recover payments made under an unconstitutional statute and payments made under a statute which is invalid for some other reason. This is not the only area in which an expected doctrinal distinction has failed to emerge. Professor Palmer, for example, criticizes some courts' requirement that even tax payments made because of mistake of fact be "involuntary" in order to raise a claim in restitution for their return. 3 G. PALMER, *supra* note 4, § 14.20, at 256-57. For an alternative approach arguably giving more play to such considerations, see *infra* p. 914.

144. See, e.g., *Upchurch Packing Co. v. United States*, 151 F.2d 983 (5th Cir. 1945); *Snyderman v. Isaacs*, 31 Ill. 2d 192, 201 N.E.2d 106 (1964); cf. *Johnson*, *supra* note 25, at 913.

145. See also *Consolidated Distilled Prods. Inc. v. Mahin*, 56 Ill. 2d 110, 306 N.E.2d 465 (1973).

ploy any of the versions of the defense against the intermediary, it retains the illegal tax money at the conclusion of the suit. If a statute restricts actions to recover illegal taxes to "taxpayers," the government will permanently retain the illegal taxes because the customers, not being statutory taxpayers, will be unable to sue. Even if the customers are able to sue the government and have a claim, it seems unlikely that all of them will do so successfully. Thus, the probable, ultimate result of permitting the defense in any of these cases is to permanently leave some or all of the illegal tax with the government. A broader defense, such as that in *Shannon v. Hughes & Co.*, will leave illegal tax money with the government more often than will a narrower defense such as that the majority of the courts recognize. Denying the defense altogether, as did the majority in *123 East Fifty-Fourth Street*,<sup>146</sup> in part, represents a judgment that it is better to chance leaving some or all of the illegally collected money with the plaintiff<sup>147</sup> than it is to leave it with the government.<sup>148</sup>

If, as suggested here, courts are concerned about protecting the public fisc, one might well ask why the majority of courts has agreed upon a relatively narrow passing-on defense that is valid only if the intermediary has "specifically charged" the tax. Indeed, assuming it makes policy sense to leave the illegal tax with the government rather than award it as a windfall to an undeserving plaintiff, one must ask why courts have not moved to the broader *Shannon v. Hughes & Co.* approach of requiring the plaintiff affirmatively to show that it "bore the burden" of the taxes it paid to the government even where it has not specifically charged its customers the tax. The difficulties of proof inherent in the *Shannon v. Hughes & Co.* approach and the doctrinal inconsistency of that court's approach may be reasons for not requiring such proof. We will defer discussion of the proof problems that *Shannon v. Hughes & Co.*'s general approach invites until Part IV<sup>149</sup> and concentrate here on the doctrinal problems inherent in that court's

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146. See *supra* p. 880-81.

147. Despite the fact in such cases that the funds are arguably being held for the customers of the middleman, the middleman has title to those funds, and, to the extent that its customers do not recover, it will likely retain the funds in its own right. See *Illinois Bell Tel. Co. v. Slattery*, 102 F.2d 58 (7th Cir. 1939). But see *Market St. Ry. Co. v. Railroad Comm'n*, 28 Cal. 2d 363, 171 P.2d 875 (1946).

148. It is, of course, possible that all customers who arguably "bore the burden" of the tax will assert their rights against the middleman either singly or through a class action and that all will recover. This prospect, however, seems unlikely.

149. See *infra* p. 915-16.

approach.

As indicated earlier,<sup>150</sup> because the customers made no mistakes when they paid over the higher lump-sum price to Hughes & Co., customer rights can have little to do with this court's interpretation of the defense. As a matter of contract between those customers and Hughes & Co., the customers obtained their ice cream for the higher price and have no basis for asserting claims against either Hughes & Co. or against the government. Consequently, there is, under these facts, no basis for the physical transfer analysis that Judge Hand outlined in *123 East Fifty-Fourth Street*<sup>151</sup> and that Judge Cardozo utilized in *Duffy-Mott*.<sup>152</sup> The customers did not get any claim against the intermediary when they handed over the inflated price, and the intermediary was not, equitably or otherwise, asserting a claim against the government on their behalf. What, then, could the *Shannon v. Hughes & Co.* court have meant when it said that allowing the plaintiff to recover would "result in the unjust enrichment of the one seeking to recover the tax from the commonwealth"?<sup>153</sup> If it does not mean that the plaintiff will be unjustly enriched by obtaining someone else's property, the court probably means that Hughes & Co. would obtain a windfall or be overcompensated if it recovered. But, as already discussed,<sup>154</sup> the court rejected Hughes & Co.'s proof that the imposition of the illegal tax had harmed it financially, and thus the court had insufficient facts with which to conclude that Hughes & Co., in fact, would get a windfall if it had recovered the illegal tax.

What the *Shannon v. Hughes & Co.* court appears to mean is that the plaintiff will be "unjustly enriched" in a real, compensatory sense simply because it increased its prices to customers by the amount of the tax and got that increased price from the customers. For the *Shannon v. Hughes & Co.* court, the traditional physical transfer model determines whether the plaintiff has been "unjustly enriched" despite the fact that third party rights, at the bottom of the model's application in these cases, are absent. There is no "unjust enrichment" in the sense of obtaining someone else's property because there are no other third party rights, and there is no "unjust enrichment" in an overcompensation sense because, as

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150. See *supra* p. 902-03.

151. 157 F.2d 68, 70 (2d Cir. 1946) (Hand, J., dissenting). See *supra* p. 890-91.

152. 244 N.Y. 351, 155 N.E. 669 (1927). See *supra* p. 892-93.

153. 207 Ky. at 536, 109 S.W.2d at 1177.

154. See *supra* p. 887-88.

indicated earlier,<sup>155</sup> the party that actually "bears the burden" of a tax is not determined by the physical transfer model but, rather, by a far more complicated economic analysis.<sup>156</sup>

Although the desire to protect the treasury might in some respects animate decisions in this area, the physical transfer approach does not contain the flexibility with which to directly advance a policy that an award should not overcompensate a plaintiff in a tax refund suit. The approach does not permit one to determine whether overcompensation, in fact, would occur. Moreover, it does not allow the court the latitude to give special treatment to the government as revenue-spreader because the approach, on its surface, takes no account of the special status of the government as a defendant. Similarly, if one wanted to distinguish between claims whose payment would undesirably disrupt governmental finance, and claims which would not,<sup>157</sup> different doctrine would be necessary because, as applied, this doctrine operates without regard to such factors. The existing doctrine counts as relevant only the physical method through which the intermediary passes on the tax. If one is to give explicit consideration to the many other factors that might be important in the application of the passing-on defense generally or in tax cases specifically, one ought to consider a

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155. See *supra* p. 887.

156. The *Shannon v. Hughes & Co.* court is not alone in taking this approach to determining who "bore the burden" and, by implication, "overcompensation." Despite very early recognition of the shared burden of most passed-on taxes, see *Johnson, supra* note 25, a current federal statute requires that a taxpayer seeking a refund must demonstrate that it has not collected the amount of the tax from its customers. 26 U.S.C. § 6416(a)(1)(A) (1982). This mechanical approach is said to establish that the intermediary has suffered "no loss." *Travel Indus. of Kansas, Inc. v. United States*, 425 F.2d 1297, 1300 (10th Cir. 1970). A challenge to a similar computation method in a predecessor statute was defeated in *DeNobili Cigar Co. v. Commissioner*, 153 F.2d 404 (2d Cir. 1946). But see *Terrell v. Bowers*, 163 Ohio St. 72, 125 N.E.2d 332 (1955). In this case, an intermediary was suing for a refund of a tax imposed on sales. The statute permitted the vendor, in most cases, to collect the tax from customers and give them a receipt in exchange or to prepay the tax, and (rather than collect it from customers) "print plainly on the product sold or offered for sale a statement that the tax levied had been paid in advance." *Id.* at 76, 125 N.E.2d at 335. Because of the different way the tax was handled, the court determined that the intermediary "b[e]fore the thrust of the tax upon the sales he made," and permitted recovery. *Id.*

This method might be justified on the basis of administrative convenience and as a substantive determination that, unless the intermediary bore *all* the burden (*i.e.* added nothing to the price), he is not deserving of a tax refund. The substantive determination does not proceed from the law of restitution, however, and there is considerably more room in legislation for arbitrary line drawing for administrative convenience than there is in the common law where lines purportedly are drawn on a principled basis.

157. Cf. 3 G. PALMER, *supra* note 4, § 14.20.

doctrinal approach that includes criteria other than the method of passing-on.<sup>158</sup>

158. From time to time, courts use plaintiff's "fault" as an additional basis for denying recovery in "specifically charged" cases. See, e.g., *Decorative Carpets, Inc. v. State Bd. of Equalization*, 58 Cal. 2d 252, 373 P.2d 637, 23 Cal. Rptr. 589 (1962)(Traynor, J.); *Standard Oil Co. v. Bollinger*, 337 Ill. 353, 169 N.E. 236 (1929); *Richardson Lubricating Co. v. Kinney*, 337 Ill. 122, 168 N.E. 886, 889 (1929); *Kesbec, Inc. v. McGoldrick*, 278 N.Y. 293, 16 N.E.2d 288 (1938). Superficially, this rationale seems similar to that deployed to bar restitution to plaintiffs under illegal contracts. See generally 2 G. PALMER, *supra* note 4, §§ 8.1-9; Wade, *Restitution of Benefits Acquired Through Illegal Transactions*, 95 U. PA. L. REV. 261 (1947). But what is the culpable activity of the intermediary that would bar an otherwise good claim to restitution? Perhaps the best "guilt" case might be misrepresentation: while challenging imposition of the tax, the intermediary was "misrepresenting" to its customers that they were paying a tax by specifically charging them a "tax." If this is the fault case, it does not bear scrutiny.

What the intermediary has done in a "specifically charged" case is to label and collect from customers a "tax" that the intermediary was disputing or would dispute. Such conduct does not seem unacceptable because of its inevitable influence on customer decisions to purchase. It seems implausible—and unsupported by economic evidence—that labeling a price increase a "tax" lowers a customer's sensitivity to price and therefore encourages purchases at the price-plus-tax total that would not otherwise have been made. A customer probably will buy just as readily at 15 cents as he would at 10 cents plus 5 cents tax. In other words, there is probably no customer "injury" causally related to the "misrepresentation" on which to build a "fault" analysis; labeling a price hike a "tax" does not likely cause a sale that otherwise would not have been made. There is, in addition, nothing inherently evil about "specifically charging" a disputed tax—such conduct is socially acceptable if the intermediary does not proceed forward to litigate the disputed tax or litigates it and loses. In no case has a court deploying the "fault" rationale found an intent to deceive on the part of the intermediary. In short, there appears to be nothing wrong with the conduct of specifically charging a disputed tax.

An alternative reading is that the plaintiff is at fault for seeking a windfall or property that does not belong to it. This reading of "fault" depends for its content on whether the plaintiff otherwise has a right to restitution—if there is no right to restitution, plaintiff is "guilty" for seeking recovery. As discussed in the text, no court has sufficiently addressed the facts to determine whether there, in fact, would be a windfall in the sense of recovery exceeding actual loss. Moreover, even if recovery would be a "windfall," in the sense of the recovery exceeding actual loss, that fact does not make seeking restitution here "wrongful": the measure of recovery in restitution—defendant's gain—often results in an award exceeding actual loss. And if plaintiff is at fault for seeking "property which does not belong to it," that determination is based on the idea that someone else has "equitable title" to the tax money and thus lacks independent content.

Although Lord Mansfield's dictum in *Moses v. Macferlan*, 2 Burr. 1005, 97 Eng. Rep. 976 (1760), that the defendant "may give in evidence any equitable matter, in order to discharge himself" can supply authority for limiting a plaintiff's recovery either of a windfall or of someone else's property, as it did in *Shannon v. Hughes & Co.*, 270 Ky. 530, 535, 109 S.W.2d 1174, 1176 (1937). The "wrongful conduct" rationale as used here simply states the conclusion; it does not supply a reason why, in this type of case, plaintiff's attempt to divest unjust enrichment and recover in the process makes plaintiff's conduct "inequitable," whereas in other restitution cases, it does not.

#### IV. ALTERNATIVES FOR SOLVING PASSING-ON PROBLEMS IN RESTITUTION

In the last Part, we considered the doctrines that courts deploy in dealing with the passing-on problem in cases involving restitution of illegal taxes. As suggested in Part III, the doctrines that courts use in deciding the cases either fail to take substantive policy into account or appear to be makeweights to support judgments at which the courts arrive on other grounds. In this Part, the focus will be on the alternatives that one might consider in dealing with passing-on in restitution, both within and outside of the tax area.

In cases in which the passing-on defense is successful, once the buttressing doctrines considered in Part III are removed, one is left with the general idea that, as between the government and the intermediary claimant, the equities are, at minimum, balanced, and therefore the government should retain the tax money. Those equities are at best<sup>159</sup> balanced under the physical transfer model because, although the government has no right to the money, courts also perceive the intermediary to have no right to the money because that money belongs "in equity" to the customers.<sup>160</sup> The physical transfer method, which generates this doctrinal approach, is most in accord with traditional restitutionary doctrine and has the clear advantage of predictability and administrative ease of use. Using this method, one can more or less readily determine the outcome of a case by reference to fixed, physical evidence. But substantive policies, which might animate a decision on the merits, are buried in this relatively mechanical formula for resolving the dispute. Moreover, the alternative resolutions under the physical transfer approach appear to be unrelated to anything but such physical events. If the intermediary has specifically charged the illegal tax, the government in many cases will keep it regardless of who bore the burden of the tax, despite some probable intermediary loss, and despite the fact that the government has no right to the tax money. If the intermediary has added the tax into the price, then the intermediary recovers all the tax money under the physical transfer approach regardless of who actually bore the burden of the tax and despite probable overcompensation. Courts, if

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159. Arguably, the government's function of spending its income—legal and illegal—for the public welfare gives it the edge over a plaintiff which will not spread its windfall gains as broadly. See *supra* p. 899-900.

160. See *supra* p. 890.

possible, ought to avoid results such as these, devoid as they are of substantive policy support. The *Shannon v. Hughes & Co.* court's expression that allowing the plaintiff to recover would "result in the unjust enrichment of the one seeking to recover the tax from the commonwealth"<sup>161</sup> is a useful way to surface a policy-based weighing process in these cases.

The policy considerations behind the law of restitution imply denying a plaintiff relief if that relief creates "unjust enrichment" for the plaintiff.<sup>162</sup> Because a central underlying policy of the law of restitution is that of preventing unjust enrichment, a judgment in restitution that "unjustly enriches" a plaintiff would be self-defeating. But notice that this doctrinal explanation of a defendant's victory is conceptually very different from one that justifies a defendant's victory on the basis that the illegal tax does not unjustly enrich the defendant. A defendant successfully deploying the "unjust enrichment of the plaintiff" defense will not win because the *defendant* was not unjustly enriched; it will win because the cure—an award of restitution to this plaintiff—would be no better than the disease. Denying recovery on the grounds of "unjust enrichment of the plaintiff" seems most accurately to reflect the dynamics of these tax cases themselves.

It appears that most courts ultimately deny recovery primarily because they believe that the wrong plaintiff sought recovery, or because events extraneous to the transaction between the middleman and the government (the plaintiff's passing-on the tax) have divested that plaintiff of the rights it otherwise might have had. Framing the question as whether the recovery sought would result in the *claimant's* unjust enrichment properly redirects our attention from the defendant and the manner in which the defendant acquired the enrichment to the plaintiff and to the results that might follow a judgment in plaintiff's favor. In these cases, an appropriate plaintiff which met other requirements for recovery<sup>163</sup> and did not pass-on the tax would be entitled to recover the illegal tax. Where the plaintiff has passed-on the tax, the government has not strengthened its own case for retention of the illegal tax money; instead, the original balance of equity favoring the inter-

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161. 270 Ky. at 536, 109 S.W.2d at 1177 (1937).

162. Cf. RESTATEMENT (SECOND) OF RESTITUTION, Topic 3, Introductory Note at 157 (Tent. Draft No. 1 1983).

163. As discussed earlier, cases in this area typically require "protest" or "duress" in order for a plaintiff to recover an illegal tax in restitution. In the cases under consideration, those requirements were met. See *supra* note 21.



mediary has shifted because of the intermediary's unilateral action in charging its customers the tax. Following collection of the illegal tax, the government has not gained "equity," the plaintiff has lost it.

The critical question in the application of the "unjust enrichment of the plaintiff" formula is how to determine whether a recovery of restitution would "unjustly enrich" the plaintiff. Determining whether restitution would "overcompensate" the plaintiff would seem the most natural approach to the problem, but under most of the cases as the courts have decided them, the physical transfer model, not the compensation model, would resolve that question. If the plaintiff had specifically charged the tax, the tax money "in equity" would belong to the customers. In such a case, if the plaintiff is not seeking the recovery on their behalf, an award to the plaintiff would constitute "unjust enrichment."<sup>164</sup> Although this approach has the merit of administrative convenience, it has no nondoctrinal content because it turns on the customers' "equitable" rights to the tax money which, in turn, are governed by physical events. Moreover, if the government raised the passing-on defense in the other situations potentially calling for a restitutionary remedy, the physical transfer model engenders unpredictable results.

For example, consider two nontax situations:

Example 1: Defendant embezzled money from the plaintiff company. Defendant covered the embezzlement with false entries of "costs" in the plaintiff's books. Those costs were specifically reflected as items making up the price of goods plaintiff sold to its customers who are now unidentifiable.

Example 2: Plaintiff made a large but mistaken additional payment to the defendant, one of its suppliers of component parts. That payment was specifically reflected as a "cost" component in the price of goods plaintiff sold to its own customers, and those customers are now unidentifiable.

In both of these cases, the defendant might raise the passing-on defense to the plaintiff's restitution claim. As the problems have been presented, the unidentifiable customers, in theory, would have plausible restitution claims against the plaintiff-seller in both situations.<sup>165</sup> Accordingly, to use Judge Hand's analysis in *123 East*

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164. See *supra* p. 890.

165. See *123 East Fifty-Fourth St.*, 157 F.2d at 70 (Hand, J., dissenting); cf. *Wayne County Produce v. Duffy-Mott*, 244 N.Y. 351, 155 N.E. 669 (1927).

*Fifty-Fourth Street*, the plaintiff in both situations would be the constructive trustee of the additional funds, and, when those funds were "paid" to the defendant, plaintiff would become a constructive trustee of the resulting restitution claim against the defendant.<sup>166</sup> If the customers are now unidentifiable, "unjust enrichment" of the plaintiff would result from a decision in his favor because the money being sought does not, "in equity," belong to the plaintiff. For purposes of applying the defense under this analysis, Example 1 and Example 2 are indistinguishable.

Perhaps courts ought to decide the cases differently even if the plaintiffs in both were entirely successful in recovering from their customers all of the out-of-pocket loss they temporarily suffered at the hands of the defendants.<sup>167</sup> The plaintiff in the embezzlement situation would have the stronger of the two claims, and decisions in analogous situations suggest that plaintiff would prevail in that first example.

Numerous embezzlement cases in which the defendant trustee "borrows" money from a trust fund, for example, result in orders for restitution of the defendant's profits despite defendant's replacement of the entire embezzled sum prior to the suit.<sup>168</sup> Courts explicitly hold the absence of "loss" in such fiduciary situations is no obstacle to the plaintiff's recovery.<sup>169</sup> Other types of wrongdoing also result in restitution to a plaintiff who has not suffered an out-of-pocket loss. In *Catts v. Phelan*,<sup>170</sup> Phelan and Morris hired Catts to draw the tickets in a lottery they were conducting for the state of Virginia. Catts, in turn, hired another to purchase a ticket. He then prepared a matching ticket with the same number, "drew" that matching ticket as the winning ticket, and shared the \$12,500 winnings with the ticket holder he had hired. In awarding restitution to Phelan and Morris, the court considered it insignificant whether Phelan and Morris held the \$12,500 "in their own right, or

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166. Cf. 157 F.2d at 70-71 (Hand, J., dissenting).

167. This would be possible, for example, if the demand for what the intermediary was selling was totally inelastic, and therefore, an increase in price made no difference in the amount demanded. See *supra* p. 885-86. Such a case also might be presented if the plaintiff had preexisting cost-plus contracts with its customers. In that case, sales would be determined in advance and increased cost would have little effect on the amount demanded. See also *infra* note 194.

168. See, e.g., *In re Bond & Mortgage Guarantee Co.*, 303 N.Y. 423, 103 N.E.2d 721 (1952); *Wendt v. Fischer*, 243 N.Y. 439, 154 N.E. 303 (1926).

169. *In re Bond & Mortgage Guarantee Co.*, 303 N.Y. 423, 103 N.E.2d 721, 725 (1952); *Wendt*, 154 N.E. 303, 304 (1926).

170. 43 U.S. 376 (1844).

as trustees for others interested in the lottery.”<sup>171</sup> What the court found significant was that the plaintiffs had the “legal right” to the \$12,500 and that the defendant’s fraud had deprived them of that right.<sup>172</sup>

In *Reading v. Attorney General*,<sup>173</sup> a lorry operator bribed Reading to accompany a liquor-carrying lorry wearing his military uniform so that the lorry would escape inspection by officials. The House of Lords, which indicated it was immaterial that the Crown had not actually suffered loss, affirmed the Crown’s restitutionary award of Reading’s bribery money.<sup>174</sup> *Diamond v. Oreamuno* is a more contemporary example in a comparable situation.<sup>175</sup> There, a corporation sought restitution under state law <sup>176</sup> from its directors of profits they amassed by trading on inside information about the corporation. In response to the defense that the corporation had suffered no loss, the court said:

[An allegation of damages] has never been considered to be an essential requirement for a cause of action founded on a breach of fiduciary duty. . . . This is because the function of such an action, unlike an ordinary tort or contract case, is not merely to compensate the plaintiff for wrongs committed by the defendant but . . . “to prevent them, by removing from agents and trustees all inducement to attempt dealing for their own benefit in matters which they have undertaken for others or to which their agency or trust relates.”<sup>177</sup>

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171. *Id.* at 381.

172. The report of the case does not indicate whether those who purchased tickets for that lottery were identifiable. Given the conduct of the defendant, it is doubtful that this was an important consideration.

173. [1951] A.C. 507.

174. *Id.*

175. 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969) (Fuld, J.).

176. *Id.* at 502-05, 248 N.E. at 913-14, 301 N.Y.S. at 84-86.

177. *Id.* at 498, 248 N.E. at 912, 301 N.Y.S. at 81 (quoting *Dutton v. Willner*, 52 N.Y. 312, 319 (1873)). The court also rejected the defendant’s claim of potential double liability. Although a suit by the actual purchasers of the shares was remote, the court indicated that it was quite common for a plaintiff to seek recovery of something to which others claimed to have superior rights. In such cases, the court indicated that it would not permit the possibility of double recovery to act as a defense; if the defendant wants protection, it can “interplead any and all possible claimants and bind them to the judgment.” *Id.* at 504, 284 N.E. at 915, 301 N.Y.S. at 86.

See also *Jersey City v. Hague*, in which former mayors illegally retained 3% of city employee salaries as a condition of continued employment. 18 N.J. 584, 115 A.2d 8 (1955). The majority granted restitution to the city over a dissent that maintained that the rights to restitution, if any, lie in the employees, not the city, and that the court, therefore, could not grant the city restitution of those funds on the city’s own behalf. *Id.* at 607-08, 115 A.2d at 22-23.

In these cases, the need to divest "unjust enrichment" and to remove the profit motive from wrongful activity in various "trust" situations has been strong enough to outweigh any competing policy against overcompensating plaintiffs.<sup>178</sup> Divesting unjust enrichment also has implicitly outweighed any policy of awarding a plaintiff property that, in equity, belonged to someone else; in each of these cases, one could argue that someone other than the actual plaintiff actually bore the loss.<sup>179</sup> If passing-on situations such as Example 1 were to arise, it is likely that a policy of removing the profit motive from wrongful activity also would outweigh any supposed policy against awarding the plaintiff a recovery the courts perceive to belong "in equity" to the plaintiff's unidentifiable customers. The physical transfer approach to the passing-through defense, however, would make no distinctions between the embezzlement example, where the urge and policy reason to separate defendant and his gain are very strong, and mistake cases such as Example 2, where the same urge and policy support are comparatively weaker.<sup>180</sup> The physical transfer model simply does not operate with regard to such policy considerations. Similarly, the transfer model, easy to apply as it is, masks important substantive

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178. See Dawson, *Restitution or Damages*, 20 OHIO ST. L.J. 175, 179 (1959).

When the wrongful activities of the defendant are the focus of the court's attention in a restitution case, the resulting award of restitution is not, in theory, "punishment." The award of restitution is generally limited to "unjust enrichment" which, definitionally, ought to leave the defendant where he was at the outset of the wrongful activity, not any worse off. As Professor Dawson has pointed out, doctrinal expression diverges from reality in some "wrongful activity" cases; for example, an intermediary which has paid the gain over to a third party will, nonetheless, be required to make restitution if the intermediary's original acquisition of the gain from the plaintiff was the result of "conscious moral fault." Dawson, *supra* note 5, at 572.

179. See also *Edwards v. Lee's Adm'r*, 265 Ky. 418, 96 S.W.2d 1028 (1936). In *Edwards*, the defendant charged an admission price that allowed visitors access not only to defendant's cave but also to plaintiff's otherwise inaccessible cave. Despite the absence of loss on the part of the plaintiff (he had no way to get admission fees for his cave, because it was inaccessible), the court awarded him restitution. *Id.* at 427, 96 S.W.2d at 1032. *Edwards* is different from the cases under discussion, because there were no third party nonplaintiffs arguably harmed by the defendant's activity. See also *Harper v. Adametz*, 142 Conn. 218, 113 A.2d 136 (1955).

180. But see *Svithiod Singing Club v. McKibbin*, 384 Ill. 484, 51 N.E.2d 550 (1943). There, plaintiff was a club that had been taxed illegally and had specifically passed the tax on to certain of its members who ate and drank there. It argued that the benefits of the refund would be passed back to its membership, and therefore, the court should not consider it to have passed-on the tax. The court rejected the argument under that state's version of a bore-the-burden statute. *Id.* at 498, 51 N.E. at 552. The court reached the opposite result—but without the constriction of a bore-the-burden statute—reached in *Market St. Ry. Co. v. Railroad Comm'n*, 28 Cal. 2d 363, 171 P.2d 875 (1946).

policies that the courts might use to decide the cases, once one strips away doctrine.

An obvious alternative to a physical transfer analysis of the "plaintiff's unjust enrichment" is that of determining whether, in fact, an award of restitution would overcompensate the plaintiff in a tort sense and, if so, whether that overcompensation would be "unjust" under the circumstances. Although the tax cases do not support such an approach in their analysis,<sup>181</sup> as indicated earlier, courts occasionally volunteer that a decision favoring the defendant will have the positive effect of preventing a plaintiff's windfall.<sup>182</sup> Unlike the physical transfer analysis, this "overcompensation" approach does not rely on doctrinal concepts of equitable ownership that might veil the operation of other substantive reasons for a decision.

An "overcompensation" approach, however, is not without problems of its own. Making a determination whether an award of restitution, in fact, would overcompensate the plaintiff requires evidence that the restitution sought would exceed the amount that the plaintiff lost as a result of the defendant's activity. This, in turn, requires an inquiry into the amount the plaintiff actually lost as a result of the activity giving rise to the restitution claim and the extent to which passing-on enabled the plaintiff to recoup that loss.<sup>183</sup> Obviously, the litigation becomes more factually complicated with an overcompensation approach to this problem; experience with the passing-on defense in the antitrust field teaches that such factual complexity can counter other legitimate policy.

In *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*,<sup>184</sup> the Supreme Court addressed the "passing-on" defense that had been developing in the antitrust field for about twenty-five years.<sup>185</sup> In

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181. See *supra* p. 887-88.

182. See, e.g., *Decorative Carpets, Inc. v. State Bd. of Equalization*, 58 Cal. 2d 252, 253, 373 P.2d 637, 638, 23 Cal. Rptr. 589, 590 (1962); *Richardson Lubricating Co. v. Kinney*, 337 Ill. 122, 129, 168 N.E. 886, 889 (1929).

183. This, in turn, potentially opens another complicated inquiry: plaintiff's argument that the court should not consider it a "windfall," in the sense of recovery exceeding loss, if, owing to market or other pressures, the intermediary must pass the windfall back to customers in the form of future lower prices? The need to contain the inquiry and an analogy to tort notions of compensation suggests the text's definition of "windfall," but one can ask whether it is not somewhat arbitrary to curtail the inquiry at this point. See also *infra* note 226.

184. 392 U.S. 481 (1968).

185. See, e.g., *Miller Motors, Inc. v. Ford Motor Co.*, 252 F.2d 441 (4th Cir. 1958); *Wolfe v. National Lead Co.*, 225 F.2d 427 (9th Cir.), *cert. denied*, 350 U.S. 915 (1955); *Twin Ports Oil Co. v. Pure Oil Co.*, 119 F.2d 747 (8th Cir.), *cert. denied*, 314 U.S. 644 (1941);

defending private antitrust actions, the defendants, whom the plaintiffs accused of charging illegally high prices, contended that the impact of these artificially high prices had been "passed-on" to plaintiffs' customers. As a result, the defendants argued, the plaintiff had not shown "injury," the prerequisite to and measure of recovery under section four of the Clayton Act.<sup>186</sup> In analyzing this situation, earlier courts had relied heavily on the words of the statute that seemed to require a showing of "actual pecuniary loss" as an element of plaintiff's cause of action. Courts recognizing the defense reasoned that such loss was not evident if the plaintiffs had recouped the price increases by increasing their own prices to their customers.<sup>187</sup>

The Supreme Court disagreed and rejected the defense for several reasons useful in the resolution of the problems here.<sup>188</sup> Addressing the "absence of loss" question, the Court reasoned:

If in the face of the overcharge the buyer does nothing and absorbs the loss, he is entitled to treble damages. This much seems conceded. The reason is that he has paid more than he should and his property has been illegally diminished, for had the price paid been lower his profits would have been higher. It is also clear that if the buyer, responding to the illegal price, maintains his own price but takes steps to increase his volume or to decrease other costs, his right to damages is not destroyed. Though he may manage to maintain his profit level, he would have made more if his purchases from the defendant had cost him less. We hold that the buyer is equally entitled to damages if he raises the price for his own product. As long as the seller continues to charge the illegal price, he takes from the buyer more than the

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*Atlantic City Elec. Co. v. General Elec. Co.*, 226 F. Supp. 59 (S.D.N.Y.), *interlocutory appeal denied*, 337 F.2d 844 (2d Cir. 1964).

186. Section four of the Clayton Act provides in part that "any person . . . injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefore . . . and shall recover threefold the damages by him sustained . . ." 38 Stat. 731 (1914) (current version at 15 U.S.C. § 15 (1983)) (emphasis added).

187. See, e.g., *Miller Motors, Inc. v. Ford Motor Co.*, 252 F.2d 441 (4th Cir. 1958); *Wolfe v. National Lead Co.*, 225 F.2d 427 (9th Cir.), *cert. denied*, 350 U.S. 915 (1955); *Clark Oil Co. v. Phillips Petroleum Co.*, 148 F.2d 580 (8th Cir.), *cert. denied*, 326 U.S. 734 (1945). See generally Pollock, *Standing to Sue, Remoteness of Injury, and the Passing-On Doctrine*, 32 ANTITRUST L.J. 5 (1966); Comment, *Monetary Recovery under Federal Antitrust Statutes*, 45 TEX. L. REV. 856 (1967); Note, *The Defense of "Passing On" in Treble Damage Suits Under the Antitrust Laws*, 70 YALE L.J. 469 (1961).

188. The antitrust cases are not directly useful because of the statutory requirement that there be "injury" to the plaintiff before a court will permit recovery. The doctrine of the law of restitution explicitly requires no such injury but, rather, permits recovery if the plaintiff demonstrates the unjust enrichment of the defendant.

law allows. At whatever price the buyer sells, the price he pays the seller remains illegally high, and his profits would be greater were his costs lower.<sup>189</sup>

Given the scholarly analysis of this problem that preceded *Hanover Shoe*,<sup>190</sup> the Court undoubtedly was aware<sup>191</sup> that it was measuring "injury" for purposes of the statute in a way that was not necessarily equivalent to out-of-pocket loss. As with passed-on illegal taxes, the victim who passed the entire amount of the overcharge on to its customers could suffer a loss of sales due to its higher prices,<sup>192</sup> and the loss of profits resulting from lost sales volume could be much less than the amount of the overcharge to be recovered from the defendant.<sup>193</sup> Despite this probable disparity, "injury" was measured in these cases as the difference between the illegally high price and the price at which the goods would have been sold to the middleman absent the illegal activity.<sup>194</sup>

Evidentiary problems, which should be minimized in the antitrust field to encourage vigorous private enforcement, thus motivated the *Hanover Shoe* Court to define and measure compensatory "injury" as something probably different in most cases from plaintiff's out-of-pocket loss.<sup>195</sup> Even if the antitrust plaintiff recoups some of the defendant's price increase in plaintiff's own prices, thereby mitigating some of the plaintiff's net out-of-pocket loss, courts should ignore the mitigation of out-of-pocket loss in fixing the amount of plaintiff's damages.<sup>196</sup>

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189. *Hanover Shoe*, 392 U.S. at 489.

190. See *supra* note 187.

191. The Court itself cited several such secondary sources. 392 U.S. at 490-92, n.8.

192. Cf. *Hanover Shoe*, 392 U.S. at 492-93; Bondurant, *supra* note 25, at 370-71.

193. Because courts calculate these measures of injury differently, it is unlikely that both measures would produce the same result. See *Hanover Shoe*, 392 U.S. at 492-93.

194. The Court recognized a type of case in which a middleman who passed on the overcharge might suffer no loss whatsoever—the case in which there was an inelastic market for plaintiff's goods or services and in which defendant had raised the product's price to plaintiff and plaintiff's competitors. *Hanover Shoe*, 392 U.S. at 491-92. But the difficulties of attempting to prove such was the case, and the accompanying increase in the complexity and expense of litigating private antitrust actions justified rejecting the defense for all but a very limited number of cases with minimal problems of proof. *Id.* Antitrust cases in which the passing-on defense might still be available are, according to the Court, those in which the "overcharged buyer has a pre-existing 'cost-plus' contract, thus making it easy to prove that he has not been damaged." *Id.*

195. See also Note, *Standing to Sue in Antitrust Cases: The Offensive Use of Passing-On*, 123 U. PA. L. REV. 976 (1975).

196. Where the plaintiff passes the excessive charges to customers through preexisting cost-plus contracts, one can be reasonably assured that the plaintiff has not lost volume as a result of plaintiff's higher price and the showing of plaintiff's passing the cost on, of itself, becomes a relatively simple matter. Notice, however, that even in these cases, it is theoretic-

In the restitution field, recovery of the exact amount of defendant's gain also may overcompensate a plaintiff who has passed-on an illegal tax, an embezzled "cost," or a mistaken payment. One may call the overcompensation of the plaintiff, which could result from such an award of restitution, "unjust enrichment of the plaintiff." An important lesson that one may draw from the antitrust field is that courts should not permit the potential complexity of providing evidence of passing-on to counter the important policies that the substantive law otherwise advances. In cases such as the embezzlement example, where the policies of deterrence and removing the product of wrongful activity from the defendant are dominant, one might well conclude at a preliminary stage in the litigation that divesting the defendant's gain is more important than preventing a plaintiff's overcompensation; therefore, the court might reject the passing-on defense as a matter of law.<sup>197</sup> Removing the gain from the wrongdoer is of prime importance in such cases, and one might tolerate a plaintiff's windfall if awarding a windfall to a plaintiff is necessary to deprive the defendant of wrongful gain.<sup>198</sup>

Yet, courts should not disallow evidence that an award of restitution will overcompensate a plaintiff in all cases where the plaintiff has recouped from its customers the amount sought from the defendant. Where the defendant's enrichment is the result of the plaintiff's mistake, compensation of the plaintiff is a much larger and more important component of the restitution remedy

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cally possible that the middleman-plaintiff has suffered some quantifiable financial loss. The plaintiff might have lost the goodwill of its customers because of the rising price, and, in turn, the loss of goodwill might lead to fewer cost-plus contracts in the future.

197. One can utilize this form of analysis, perhaps best suited to the compensation model, in conjunction with the physical transfer model even though the analysis becomes somewhat strained under this model. One could reason at an early litigation stage that even if the probable result of a recovery were to award the plaintiff something belonging "in equity" to someone else, on policy grounds, this result will be ignored for purposes of this action. The problem is that the physical transfer model is somewhat absolute in its implication that neither litigant has a "right" to the embezzled fund. A decision in favor of the plaintiff requires the conclusion that, as between the two litigants without property rights, the defendant's position is less worthy than that of the plaintiff's. Moreover, utilizing the "overcompensation" approach to passing-on, in such a case, seems more consistent with those fiduciary cases that explicitly face and decide whether overcompensation of the plaintiff will bar restitution.

198. There are obvious parallels to the dynamics of punitive damages in the tort system. One can justify the plaintiff's windfall, which can result from a punitive damage award, as a necessary evil that accompanies the monetary punishment of the defendant. *See, e.g.,* C. MCCORMICK, *LAW OF DAMAGES* § 77 (1935); W. PROSSER, *LAW OF TORTS* § 2, at 11 (4th ed. 1971).



than it is where the defendant's enrichment results from the defendant's wrongful activity.<sup>199</sup> In contrast to a "wrongful act" case, in a mistake case, the defendant may have played no part in bringing about receipt of the gain; therefore, there is neither "conduct" nor illegal profit to deter. In Example 2, the mistaken payment case, where compensation of the plaintiff becomes a more dominant reason for an award of restitution, the court probably should permit the passing-on defense—even if complex—for it goes to a dominant basis of the plaintiff's claim.<sup>200</sup>

Of course, there is a continuum of cases between the extremes of mistake and embezzlement, and line drawing along that continuum presents difficult problems for implementing this type of approach to the defense. For example, what of the cases, such as the tax cases that we have considered, where the government's "conduct" of collecting the illegal tax is "wrongful," but which arguably present weaker facts than embezzlement cases for depriving the defendant of an unjustified gain? One problem that accompanies the compensation approach is that of discriminating between those cases in which the court would reject the defense at the outset and other cases in which the court might admit potentially complex evidence establishing the defense. The physical transfer model avoids this line-drawing problem by making such considerations theoretically irrelevant.<sup>201</sup> An embezzlement case would, under that theory, be indistinguishable from a mistake case as long as the plaintiff passed-on the loss in the same way in both cases. As suggested earlier, however, courts probably would treat these extreme fact situations differently on the restitution spectrum. A theoretical ap-

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199. Cf. RESTATEMENT (SECOND) OF RESTITUTION § 1 comment b (Tent. Draft No. 1, 1983).

200. Although passing-on would seem to function as an "affirmative defense" to a restitution claim, one might consider shifting the burdens of production and proof to the plaintiff in the mistake situation where plaintiff's loss is the primary basis for ordering restitutionary relief. Aside from the fact that proof of loss in such cases seems more a part of a plaintiff's own case than a defense, the plaintiff in the passing-on situation has much better access to evidence that might establish loss in fact.

Allocation of the burden of proof can be vitally important in complex cases where the intermediary might shift some of the tax in different ways to different items. In such cases, placing the burden on the intermediary to prove it bore the burden of the tax might simply result in foreclosing a refund due to difficulty of proof. Placing the burden on the government that the tax was shifted might foreclose the defense for the same reason. Cf. Bondurant, *supra* note 25, at 369. For cases discussing the burden of proof under the federal "bore-the-burden" statute, see *Coates v. Commissioner*, 161 F.2d 671 (5th Cir. 1947); *William Henderson v. Commissioner*, 153 F.2d 442 (5th Cir. 1946); *Interwoven Stocking Co. v. United States*, 144 F.2d 768 (3rd Cir. 1944); *Vogel v. Knox*, 147 F. Supp. 10 (D. Minn. 1957).

201. See *supra* p. 910-11.

proach that explicitly permitted distinctions in cases along that spectrum would appear preferable in that respect to a theory that would not recognize such distinctions.

Such line drawing along the restitution spectrum is not a new problem. Although the "moral fault" criterion, which courts have used for such distinctions in the past, is the subject of criticism,<sup>202</sup> developing a way of discriminating among cases along the broad restitution spectrum is not a problem confined to passing-on situations. Rather, the very breadth of the restitution field generates the problem, and the criteria developed to deal with similar problems elsewhere in restitution could provide a solution here.<sup>203</sup> A second, more vexing, and potentially more serious problem with the compensation approach to "unjust enrichment of the plaintiff" is that it may be impossible to confine such an approach to the tax cases or, indeed, to the passing-on problem generally.

The court's use of the compensation approach in these cases means that it will award restitution of the amount of the tax to the intermediary up to the point at which such an award would overcompensate the intermediary; "unjust enrichment of the plaintiff" in an overcompensation sense is the vehicle that generates this result. Although the focus here has been on the passing-on situation in the illegal tax context, if overcompensation of the plaintiff might operate as an "unjust enrichment of the plaintiff" defense in passing-on situations, why not in other restitution situations as well? As pointed out earlier, restitution's underlying policy against unjust enrichment means that the restitution system probably cannot tolerate the award of restitution that will "unjustly enrich the plaintiff." The court's use of the compensation approach to give content to "unjust enrichment" in this context raises the substantive policy of compensation to an explicit level within restitution doctrine; furthermore, the generality of the expressed defense perhaps exposes many restitution cases to the defense and to accompanying evidentiary problems not now present within the restitution system. Thus, the implications of a compensation approach to such a generalized defense potentially cut deeply into this area of the law.<sup>204</sup> The results in cases outside the

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202. See, e.g., Dawson, *supra* note 5, at 573.

203. Cf. Friedmann, *supra* note 5. Professor Friedmann suggests property and deterrence criteria for determining when courts should permit restitution of amounts in excess of tort loss. *Id.* at 510, 551-52.

204. Perhaps the most significant implication of such a defense and approach is in the measure of recovery in restitution. Hornbook law generally defines the measure of a plain-

tax area might be unpredictable, and, if such an approach is not easily confinable, that might be reason enough to reject it for tax cases as well.

On the other hand, if the underlying substantive policy of compensation is to work its way into the doctrinal apparatus of restitution, tax cases might be an excellent starting place. Restitution of illegal taxes has historically been a special category of restitution complete with its own peculiar rules owing, undoubtedly, to the relative uniformity of facts in tax refund cases and to the special status that courts historically accord to the government as defendant. Thus, a new rule or approach that a court articulates in the context of a tax case might be doctrinally isolated as tax doctrine expands into new areas as new cases warrant. In any event, a full discussion of all potential applications and implications of a compensation model in restitution cases is beyond the scope of this article. The tax situation we have considered here can demonstrate briefly how a court might implement such an approach in that context. One can expect the compensation approach to produce different—and more rational—results than the physical transfer approach in the tax cases.

In the tax cases under a compensation approach, because specifically charging the tax is not determinative of the question

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tiff's recovery in restitution as the defendant's benefit, not the plaintiff's loss, and there are a wide variety of approaches to determining the amount of defendant's benefit. See D. DOBBS, *supra* note 3, § 4.1, at 224. Such a measure often results in a recovery for a plaintiff exceeding the plaintiff's actual loss, and because plaintiff's loss is the typical measure in tort, the restitution system at times provides a claimant a larger recovery than does the tort system on the same facts. The approach described in the text, if considered generally, might have the effect of limiting the plaintiff's recovery to the amount of actual loss in some cases despite a larger benefit to the defendant which, under the physical transfer approach, the court would "return" to the plaintiff. The measure of recovery in such restitution cases would thereby resemble a tort recovery.

Although an "overcompensation" defense brings the restitution system closer to the tort system, it does not destroy restitution's central distinguishing characteristic: basing the defendant's liability on acquisition of "unjust enrichment" and limiting a plaintiff's recovery to the amount of that unjust enrichment regardless of the size of the plaintiff's loss. There is, however, no logical requirement that the limitation of a defendant's liability must also be the measure of the plaintiff's recovery.

In cases where compensation of the plaintiff is the motivating force for an award of restitution, the upper limit could properly be said to be either the defendant's unjust enrichment or the plaintiff's loss, whichever is less. In such cases, once the court compensates the plaintiff, there is no reason to take anything more from the defendant and give it to the plaintiff. This seems to be the effect of many of the cases; it might be more rational to raise a policy against overcompensation in deserving cases rather than to submerge such a policy within a labyrinth of complicated rules that, on their surface, have little to do with such a policy.

whether an award of restitution measured by the amount of the illegal tax will overcompensate the plaintiff, the "specifically charged" restriction ceases to have the central relevance it has under the physical transfer model.<sup>205</sup> So too, the questions whether plaintiff's customers are unidentifiable or whether the plaintiff is seeking recovery in its own behalf lose their importance.<sup>206</sup> In contrast to the physical transfer approach, all cases in which the plaintiff's price to its customers rose as a result of the tax are potentially susceptible to the defense.<sup>207</sup> If the government raises the defense,<sup>208</sup> a threshold question, appropriate for partial summary judgment one way or the other, is whether, given assumed overcompensation of the plaintiff, the government nevertheless should disgorge the amount of the tax to the plaintiff. Judgments probably will differ on this question;<sup>209</sup> indeed, under this approach, courts might treat differently the various types of tax cases. For example, a court might treat a flagrantly unconstitutional tax differently from one simply beyond the statutory authority of a minor political subdivision; in the former case, a court might view a policy of depriving the government of the fruits of its "wrongful" act as outweighing the policy of avoiding overcompensation. Similarly, a court might treat an overpayment resulting from a plaintiff's mistake differently from one resulting from the government's overexpansive use of its taxing authority.<sup>210</sup> Additionally, a court might

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205. See *supra* p. 887-88.

206. See *supra* p. 897-98.

207. In this respect, the defense is consistent with currently enacted federal legislation which makes no distinction between the plaintiff that "specifically charged" the tax and the plaintiff that did not. 26 U.S.C. § 6416 (1984).

208. Federal legislation requires that a plaintiff establish, as part of its *prima facie* statutory case, that it has neither included the tax in the price charged its customers nor directly collected the tax from its customers. 26 U.S.C. § 6416(1)(A) (1984). Although the compensation approach contemplates that the passing-on defense will remain a defense to an otherwise good claim to restitution, one might consider shifting the burden of proving loss to the plaintiff once the government pleads the defense and proffers evidence of passing-on. See also *supra* note 200.

209. As an example, an Australian court said the following about the government's passing-on defense in a case very similar to ours: "If the defendant be improperly enriched on what legal principle can it claim to retain its ill-gotten gains merely because the plaintiffs have not, it is said, been correspondingly impoverished?" *Mason v. New S. Wales*, 102 C.L.R. 108, 146 (1959).

210. Plaintiffs, seeking restitution of illegal taxes, must demonstrate that they made the payments under "duress" and not as a result of a "mistake of law." See *supra* note 21. Commentators have widely criticized these requirements and some critics have concluded that these devices are backhanded ways of protecting the treasury from disruption. See *supra* note 21. There will be few "mistake" cases in the tax area until these barriers to recovery are removed, but if they are removed, such cases will present relatively weak claims

more readily require a plaintiff to prove the loss where a major disruption of governmental finance will result from restitution than in a case where the government easily will absorb the cost of the award. Finally, a court explicitly might consider the character of the government as revenue-spreader. Overcompensation of a plaintiff may be more "unjust" when the government is the defendant than in other nontax situations.

If a court, under this approach, were to allow the defense because it viewed the policies requiring the government to divest the tax as not outweighing the policy against overcompensating the plaintiff,<sup>211</sup> a potential advantage to this approach becomes apparent. Rather than choosing between an award of the entire amount of the illegal tax or nothing,<sup>212</sup> under the compensation approach, a court could divest the unjust enrichment of the government only to the extent that the plaintiff actually suffered loss on account of the tax.<sup>213</sup> Whether or not the plaintiff has "specifically charged" the tax, it is unlikely that either the intermediary or its customers bore the entire burden of the tax; rather, the intermediary and its customers likely have shared the burden.<sup>214</sup> Under the current physical transfer approach, the intermediary that "specifically charges" the tax to customers is likely undercompensated by the defense verdict, and the intermediary that added the tax into the price is likely overcompensated by an award of the amount of the tax. It arguably is fairer and more rational that intermediaries recover in a tax refund suit if and to the extent the illegal tax has harmed

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for restitution relief. In this area, particularly, one would seek to limit the plaintiff's recovery to actual compensation rather than allow a full recovery of the illegal tax in cases where the plaintiff has passed-on the tax but in a nonspecific way.

211. These probably should include consideration of the function of the government as a broad distributor of its income for the public welfare. See *supra* p. 899-900.

212. In theory, under the physical transfer approach, a recovery of less than the amount of the tax would be available to a plaintiff that "specifically charged" only part of it or that could identify only some of its customers on to whom it passed the tax. The author has not found any decisions with this detail in discussion of recovery.

213. It might appear that permitting the plaintiff to recover only its loss raises sovereign immunity problems. The *Shannon v. Hughes & Co.* court suggested this when it said that "plaintiff's recovery of restitution on account of its lost profits would result, in effect, in permitting a recovery of damages against the commonwealth for injuries sustained by plaintiff through operation of the taxing act." 270 Ky. at 536, 109 S.W.2d at 1177 (1937). The contrary seems more plausible. In fact, if the government has no entitlement to any of the tax money, then reducing the plaintiff's recovery to its actual loss is not imposing some new liability on the government but, more properly, reducing a preexisting liability in order to prevent overcompensation.

214. Cf. Bondurant, *supra* note 25, at 371; Johnson, *supra* note 25, at 923-24.

them.<sup>215</sup>

It must be abundantly clear by now that a compensation approach is extraordinarily complicated, far more complicated than

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215. One question to consider under this approach is how it might affect the rights of the customers. This problem is not as substantial as it might appear to be at first blush because customer rights, in these circumstances, are already severely limited. It should be kept in mind that, generally, the customers do not have any direct rights of their own against the government, because the "transfer" of the tax money went from intermediary to the government, not from customer directly to the government. Moreover, in those cases in which the middleman has not "specifically charged" the tax, the customers have no rights against the intermediary either. See *supra* p. 892-93. Further, the "mistake of law" doctrine probably bars customer recoveries from the intermediary unless the intermediary has first recovered from the government. Finally, in cases in which the intermediary has collected the tax from the customers and paid it over to the government, the intermediary will have its own, more traditional passing-on defense that, absent intermediary misconduct, will prevent the customers' recovery. See D. DOBBS, *supra* note 3, § 11.9, at 767-69. See also *supra* note 93. The concern is thus with rights of customers against the intermediary in the very few cases in which they have rights: cases in which the intermediary "specifically charged" them the illegal tax and thereafter recovered from the government. Under the physical transfer model as articulated by Judge Hand, the claim of the intermediary belongs "in equity" to the customers, and if that claim is replaced by a restitutionary recovery, the recovery itself belongs "in equity" to the customers. See *supra* p. 890-91.

Once one abandons the physical transfer approach, this rationale for the customer recovery loses force at the customer-intermediary level. Under a compensation approach, the intermediary is recovering in its own right, not as a representative of the customers, and the intermediary's recovery is limited to the intermediary's loss resulting from the illegal tax. It would be inconsistent with this rationale to then permit the customers to recover the amount of the intermediary's compensation—there would be no "unjust enrichment" in an overcompensation sense, and "unjust enrichment" in a physical transfer sense is, by hypothesis, not a consideration. The intermediary's own passing-on defense would appear to bar a customer recovery if, by hypothesis, the intermediary had no unjustified gain.

Assuming that the customers to whom the tax was passed-on bore some of the burden of the tax, is their "loss" of rights to recover it in this narrow situation significant? Probably the most equitable solution in these cases would be to permit the intermediary and the customers to divide up the total amount of the tax in accordance with the burden that the respective parties bore. One could reason that customers should have direct rights against the government, because the government's unjust enrichment was, in fact, partly at the customers' expense. This would, however, require a major extension of such rights against the government. Such a result is unlikely through restitution cases and is probably best accomplished by legislation.

Nevertheless, it may be worth sacrificing customer rights in that narrow situation in the interests of a more rational approach. In most passing-on cases, the intermediary and the customers share the burden of the illegal tax. Under the cases, if the court sustains the passing-on defense, the intermediary and the customers are undercompensated and the government retains the illegal tax. If the defense is unsuccessful, then the intermediary is probably overcompensated and customers undercompensated. If the customers thereafter recover "the amount of the tax" from the intermediary, they are probably overcompensated and the intermediary undercompensated. Such results are consistent only with the historic physical transfer approach to restitution and, perhaps, with a policy of easy administration of the law, but such considerations might weigh heavily in favor of the status quo. Although others may come to different conclusions, third party rights in this context appear comparatively insignificant and ought not weigh heavily in the balance.

the physical transfer approach. Such an approach requires one to ascertain the actual amount of the loss that the illegal tax has caused the intermediary and introduces litigation complexity and less certainty of outcome. In addition to the complexity of the evidence required to implement the approach,<sup>216</sup> one would expect the introduction into the restitution system of questions of causation, burden of proof,<sup>217</sup> and other tort-like questions which have been largely absent thus far. In cases where the court has not rejected the defense at the summary judgment level,<sup>218</sup> the compensation approach would substitute potentially complex inquiries into actual loss for simple, easily handled rules—an idea that the Supreme Court rejected for the antitrust field. In this and other areas of restitution,<sup>219</sup> heavy reliance on the notion of physical transfer provides a simple method for determining outcome—although the approach impedes the surfacing of underlying policy concerns, it is easy to apply. If the traditional physical transfer approach produced results that approximated the results of more complex methods, the administrative convenience and tradition of that approach would make it difficult to reject.<sup>220</sup> Unfortunately, as suggested throughout this article, who bears the burden of the tax has little to do with the physical method by which it is passed-on.<sup>221</sup>

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216. Cf. *Indian Motorcycle Co. v. United States*, 283 U.S. 570, 581 (1931) (Stone, J., dissenting), quoted in Bondurant, *supra* note 25, at 369. ("Whether the burden of a tax actually paid by a seller is actually shifted on to the buyer depends on considerations so various and complex as to preclude the assumption a priori that any particular tax at any particular time is passed on."). *Id.* See also Note, *Buyer's Recovery of Invalidated Processing Tax Under Original AAA*, 51 YALE L.J. 348, 353-54 (1941).

217. See *supra* note 200.

218. See *supra* p. 921-22.

219. Professor Oesterle forcefully demonstrates the predominance of the physical transfer model in the rules governing tracing and questions the use of such rules, which appear unrelated to substantive policy. Oesterle, *supra* note 5.

220. One commentator, critical of federal "bore-the-burden" legislation for economic reasons, opined nonetheless that "the rule-of-thumb which the legislation introduces will in many cases be sufficiently accurate to justify the statute as an administrative expedient." Johnson, *supra* note 25, at 924.

221. Might the physical transfer approach, despite what economists say, produce results that roughly accord with the desire that only the party that really "pays" the tax should "get it back"? Consider these variations. When charged a lump sum price that included the tax, the argument would go, the customers who bought, in fact, paid only what they were willing to pay on the market. They would have paid that larger amount with or without the tax, and the intermediary would have made the same sales if the tax amount had been pure profit. The customers, therefore, absorbed or "paid" none of the tax, and the intermediary must have absorbed all of it. In contrast is the intermediary which specifically charged the customer a base price plus tax. Without the specifically charged tax, that customer would have been willing only to pay the base price, and therefore, under these cir-

With the majority's physical transfer approach, we thus are left with an administratively convenient formula for deciding cases, but a formula that masks and impedes explicit policy development. It is an approach that appears to produce results that have an unknown and unknowable<sup>222</sup> correlation with policy based solutions. In addition, it has dubious potential for expansion across the range of restitution situations in which defendants might raise the passing-on defense. On the other hand, with the compensation approach, we have a policy based method of solving these problems in the tax cases and across the entire restitution spectrum. Yet, it is a method that is nontraditional and has the potential of making a heretofore simple system into a litigator's dream. The compensation approach has the capacity of producing rational results, but the cost of producing them may be too high. There is also a third direction that courts might take that is both administratively convenient and more rational than the majority approach: to disallow the passing-on defense in virtually all<sup>223</sup> tax refund cases that look

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cumstances, the customer has borne the burden of the tax. Although the argument might be superficially plausible and might have influenced development of the "specifically charged" restriction, hidden assumptions cause it to unravel.

The best way to illuminate the hidden assumptions is to take two different illegal taxes, one on "food," for which the demand (it is assumed) is relatively inelastic, and the other on "ice cream," for which the demand is relatively elastic. If an illegal tax is imposed on "food" sales at the wholesale level and the wholesaler adds the tax into the price to customers, the customers must absorb or "pay" most of the tax. They have no real freedom not to buy and must pay the increased price to obtain the food. The assumption we made earlier that they would have paid that price with or without the tax is simply invalid: these customers will pay the minimum the market requires in order to get the relatively fixed quantity of food that they require. The dynamics are, of course, different if the taxed commodity is "ice cream." In this situation, a customer that paid a higher lump-sum price might have been willing to pay that higher price regardless of the tax. In other words, the seller would have gotten that higher price with or without the tax, and therefore, the seller bore the burden of the tax. Similar dynamics will be at work if the intermediary has "specifically charged" the tax to its customers. We cannot say that they would have not paid the higher total price absent the label "tax" unless we know what it is they were buying, "food" or "ice cream." The point is that the traditional physical transfer approach, while administratively convenient, fails to take account of the variables that determine who really "pays" the tax and, perhaps therefore, who ought to "get it back."

222. The correlation is unknowable because we invariably have insufficient facts within the case to determine whether the results correspond to those a policy-based analysis would produce. Of course, the physical transfer approach impedes discovery of such facts.

223. One variant to be included in the "no-defense" approach is to permit the defense only when it is quite certain that the illegal tax has caused the intermediary no injury, as did the Supreme Court in the antitrust field. *See supra* note 194. Another alternative would be to require the plaintiff to show some injury (not how much) and to foreclose the defense once the plaintiff demonstrates injury. Both approaches are administratively convenient, but, under both, it is likely there would be overcompensation in a tort sense of the intermediary by an award of the amount of illegal tax. Overcompensation would be tolerated in



to the law of restitution for solution.

Because this approach would give almost no consideration to the passing-on defense, the administrative convenience is at a maximum. One need not consider the subsidiary questions within the passing-on defense because, as in the antitrust field, the defense would be virtually nonexistent. In addition, the results under such an approach are less arbitrary than they are under the physical transfer model. Application of the physical transfer model produces random results unrelated to a plaintiff's need to be compensated for loss, the government's need to be "deterred" from enacting illegal taxes, the government's need to avoid major shocks to its treasury, or other substantive policies that might animate decisions in this area. In contrast to the predictable—but arbitrary—results of the physical transfer approach, the "no-defense"<sup>224</sup> approach consistently deprives the government of illegal tax money and almost always will award restitution to a plaintiff that has suffered some loss.<sup>225</sup> This approach also may overcompensate to some extent because the intermediary and its customers will share the burden of the tax in most cases, but under this approach, the courts will not engage in the complicated process of determining relative shares.<sup>226</sup>

If one focuses on restitution's function of divesting unjust enrichment as well as on the loss that one bears when the government retains the fruits of its own illegal taxation, this less complex approach to the problem makes sense. Indeed, if we regard illegal

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both cases and in both there would be some assurance that the complaining plaintiff has suffered some injury resulting from the illegal tax.

224. See *supra* note 223.

225. Only where the plaintiff has passed-on the *entire* tax, and no other loss has resulted to the intermediary, will the entire award constitute overcompensation. In these situations, the variations on the "no-defense" approach can ensure that courts award restitution only to plaintiffs deserving some compensation. See *supra* note 223.

226. An implicit assumption throughout the discussion of "overcompensation" is that it may be socially desirable to leave the surplus of illegal tax over actual loss with the government rather than award it as a "windfall" to the intermediary. It is implicitly assumed that a "cost" of the "no defense" approach is that the intermediary can recover a windfall in the interests of administrative efficiency and more rational decisionmaking. One can further support the "no defense" approach by attacking this assumption.

One can question so defining "windfall" or implying that it is something to be avoided. After all, in many cases, the windfall itself might be passed back to customers in lower prices or otherwise use for purposes as socially desirable as governmental expenditure of the same money (e.g., plant improvement, more jobs, scientific advancement). Moreover, even if the plaintiff simply distributes the windfall to stockholders as profits, the money will arguably "trickle down" with economic benefits for many others. Economic rather than political considerations will determine on what the intermediary will spend the windfall if the court awards restitution. Many would argue that such a result is not all that bad.

taxation as "wrongful conduct" worth deterring and depriving of a "profit motive," such an approach easily fits within that area of restitution where the plaintiff's actual loss is largely irrelevant. Moreover, there is arguably some good to be had from providing a nominal taxpayer with a financial incentive to keep government taxation within the bounds of the law. "Undeserved" windfalls may be tolerable here as elsewhere in our system in the interests of maintaining a check on wrongful conduct.<sup>227</sup>

What about the very real concern that an award of restitution in large cases will result in major disruptions of governmental services? The "no-defense" approach will not greatly add to that problem because the change will make a difference only where the intermediary has "specifically charged" the tax. Under the current majority view, a taxpayer that has added the tax into the price does not fall victim to a passing-on defense. Moreover, courts currently have the doctrinal apparatus available to solve the fiscal shock problem. Commentators have criticized the "mistake of law" and "voluntary payment" doctrines, which often bar relief, as covert ways of protecting the government against just such shocks.<sup>228</sup> Courts might afford similar protection, but in a more direct way, by recognizing laches as a defense where delay in asserting a claim has resulted in the buildup of the claim and consequent prospect of fiscal disruption. Alternatively, a court might consider a decree that the government pay restitution in an illegal tax case in installments, rather than in a lump sum, which will not produce the same shock to the treasury.<sup>229</sup>

The results under this "no passing-on defense" approach would be to consistently deprive the government of illegal taxes, to compensate the intermediary for probable loss, and to overcompensate the intermediary to an extent determined by the different economic factors in each case. The approach affords more rational and consistent results than the current doctrine. As suggested by

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227. There are obvious analogies throughout our legal system for this approach that benefits someone who has suffered no actual loss in the interests of broader policy. Affirmative action policies confer benefits on new employees because others have been the victims of discrimination; class action recoveries often benefit those not actually injured. See *Developments—Class Actions*, 89 HARV. L. REV. 1318, 1516-36 (1976). Furthermore, punitive damage awards are thought to supply plaintiffs with windfalls. A possibly related illustration of this phenomenon from the criminal law is the exclusionary rule.

228. See 3 G. PALMER, *supra* note 4, § 14.20.

229. The problems associated with imprisonment for debt, which one ordinarily encounters in connection with an equity decree requiring the payment of money, would not have much force when the entity required to pay is the government. See D. DOBBS, *supra* note 3, § 2.9, at 98-99.

analogous developments in the antitrust field, the approach has substantial policy support of its own and that policy support has early roots.<sup>230</sup>

The problem with the "no defense" approach is in its very simplicity. In the tax area, it gives no play to the very legitimate view that a tax refund should not overcompensate plaintiffs. It does not capture the complexity and subtlety that may lie beneath decisions in this area. It probably lacks the flexibility to operate across the range of restitution cases in which courts might encounter a passing-on defense. It probably would—and should—reach a breaking point in cases outside the tax field where the defendant's conduct played no role in the acquisition of the unjust enrichment. On balance, however, it may well make sense, in the interests of administrative convenience and rational decisionmaking, to focus on the policy of deterrence and cut off the passing-on defense in restitution as courts have done in the antitrust field. As the majority decision suggested in *123 East Fifty-Fourth Street*,<sup>231</sup> if tax refunds are to be restricted to those who "bear the burden" of the tax, then perhaps legislatures, rather than courts or commentators, are the proper source of such rules.<sup>232</sup> The restitution system simply may be ill-equipped to absorb the complexity necessary for such decisionmaking.

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230. In *Southern Pac. Co. v. Darnell-Taenzer Lumber Co.*, plaintiffs sued common carriers for recovery of rates charged in excess of those that the Interstate Commerce Commission permitted. 245 U.S. 520 (1918). In denying the carriers' passing-on defense, Justice Holmes opined:

The carrier ought not to be allowed to retain his illegal profit, and the only one who can take it from him is the one that alone was in relation with him and from whom the carrier took the sum . . . . Behind the technical mode of statement is the consideration well emphasized by the Interstate Commerce Commission, of the endlessness and futility of the effort to follow every transaction to its ultimate result . . . . Probably in the end the public pays the damages in most cases of compensated torts.

*Id.* at 533.

For authorities that arguably support the "no defense" approach, see *123 East Fifty-Fourth Street*, 157 F.2d 68 (2d Cir. 1946); *Builders' Club of Chicago v. United States*, 14 F. Supp. 1020 (Ct. Cl. 1936); *State v. Sunburst Ref. Co.*, 76 Mont. 472, 248 P. 186 (1926), *cert. denied*, 273 U.S. 722 (1926); *Mason v. New S. Wales*, 102 C.L.R. 108, 146 (1959); *RESTATEMENT OF RESTITUTION* § 141(1) (1937).

231. 157 F.2d 68 (2d Cir. 1946). *See supra* p. 880-81.

232. There are other administratively convenient solutions to the problem here. One solution is to preclude an intermediary from recovery if it has raised the price after the tax is imposed. Another solution is to put the burden on the intermediary to show that changes in its pricing following the tax did not result in its shifting the burden to customers. *Cf. supra* note 156. Such solutions, however, have questionable analytical soundness and no basis in the law of restitution, and are more appropriate for legislative development.

## V. CONCLUSION

We have examined a very narrow line of cases that force one to consider the interplay of doctrine and substantive policy within the field of restitution. The courts have decided most of the cases using a straightforward application of restitutionary doctrine that, in turn, comes from an approach relying heavily on notions of physical transfer. The results of the doctrinal application fail to reveal any correlation with underlying substantive policy. Rather, courts variously overcompensate and divest unjust enrichment or undercompensate and leave the gain with the defendant based on the way the tax is passed-on, a fact having little apparent relationship with anything but pure doctrine. The results are random, bearing no consistent relationship with a policy of depriving the government of illegal taxes or with a policy of compensating plaintiffs for loss resulting from illegal taxes. Other than administrative convenience, little supports this majority approach.

Unfortunately, alternatives are not easily chosen. The results under current doctrine are irrational, but the policy-based "compensation" approach may come at too high a price in complexity to make the gains in rational decisionmaking worthwhile. The administratively convenient approach of barring the defense entirely and leaving it to legislatures to prevent overcompensation of intermediary taxpayers in tax refund suits is more rational than the current approach because it is consistently related, at least, to a policy of divesting illegal taxes. This latter solution, unfortunately, does not capture the probable complexity of the actual decisionmaking process and lacks the flexibility for easy expansion outside the tax field.

Ideally, one could achieve rational results, predictability, and certainty with easy to apply doctrine based explicitly on substantive policy. In the situation examined here, however, a desirable increase in rational results seems, in an almost paradoxically physical sense, to come at the expense of other desirable doctrinal qualities. It may be impossible to develop "rules" that courts can easily administer and, at the same time, that capture the underlying complexity of decisions in the restitution field. One hopes that those working in this field can manage to inject substantive policy into restitutionary doctrine without destroying the simple, primitive, and perhaps intuitive operation of the system that may be its identity and makes it so attractive.